

BLUE HOLDINGS, INC.  
Form 10-Q  
August 14, 2007

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

**FORM 10-Q**

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

**For the Quarterly Period Ended: June 30, 2007**

**Commission File Number: 000-33297**

**BLUE HOLDINGS, INC.**

(Exact name of registrant as specified in its charter)

**Nevada**

(State or other jurisdiction of incorporation or organization)

**88-0450923**

(IRS Employer Identification No.)

**5804 E. Slauson Ave., Commerce, CA 90040**

(Address of principal executive offices)

**(323) 725-5555**

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.  
Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer.

Large Accelerated Filer  Accelerated Filer  Non-accelerated Filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  
Yes  No

As of August 13, 2007, 26,232,200 shares of the registrant's common stock were outstanding.

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**BLUE HOLDINGS INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
**AS OF JUNE 30, 2007 AND DECEMBER 31, 2006**

**ASSETS**

	2007	2006
	(Unaudited)	
Current assets:		
Cash	\$ 184,519	\$ 109,031
Due from factor, net of reserves of \$185,417 and \$178,801, respectively	1,239,041	1,366,588
Accounts receivable, net of reserves of \$1,156,016 and \$901,941, respectively:	-	
- Purchased by factor with recourse	6,279,254	7,662,198
- Others	386,569	19,312
Inventories, net of reserves of \$1,030,158 and \$1,742,893, respectively	8,461,464	5,394,006
Income taxes receivable	2,016,875	2,030,919
Deferred income taxes	1,847,472	2,488,082
Prepaid expenses and other current assets	1,308,530	396,810
Total current assets	21,723,724	19,466,946
Deferred income taxes	774,293	-
Property and equipment, less accumulated depreciation	1,648,022	1,611,171
Total assets	\$ 24,146,039	\$ 21,078,117

**LIABILITIES AND STOCKHOLDERS' EQUITY**

Current liabilities:		
Bank overdraft	\$ 811,773	\$ 266,788
Accounts payable	1,474,783	2,820,024
Short-term borrowings	14,069,439	10,026,814
Due to related parties	125,734	710,153
Advances from majority shareholder	2,041,116	1,876,991
Current portion of liability for unrecognized tax benefits	96,850	-
Accrued expenses and other current liabilities	1,674,769	2,133,932
Total current liabilities	20,294,464	17,834,702
Non-current portion of liability for unrecognized tax benefits	170,884	-
Total liabilities	20,465,348	17,834,702
Stockholders' equity:		
Common stock \$0.001 par value, 75,000,000 shares authorized, 26,232,200 and 26,057,200 shares issued and outstanding, respectively	26,232	26,057
Additional paid-in capital	5,329,163	4,964,091
Accumulated deficit	(1,674,704)	(1,746,733)
Total stockholders' equity	3,680,691	3,243,415
Total liabilities and stockholders' equity	\$ 24,146,039	\$ 21,078,117

**SEE NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

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**BLUE HOLDINGS INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)**  
**FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2007 AND 2006**

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2007	2006	2007	2006
Net sales	\$ 8,401,971	\$ 15,180,652	\$ 16,842,193	\$ 27,058,531
Cost of goods sold	3,910,830	7,752,299	7,278,591	13,680,915
Gross profit	4,491,141	7,428,353	9,563,602	13,377,616
Selling, distribution & administrative expenses	4,057,091	4,322,680	8,577,659	8,923,087
Income before interest expense and provision for income taxes	434,050	3,105,673	985,943	4,454,529
Interest expense	414,389	214,449	752,533	385,762
Income before provision for income taxes	19,661	2,891,224	233,410	4,068,767
Provision for income taxes	12,425	1,176,728	108,916	1,674,095
Net income	\$ 7,236	\$ 1,714,496	\$ 124,494	\$ 2,394,672
Earnings per common share, basic and diluted	\$ -	\$ 0.07	\$ -	\$ 0.09
Weighted average shares outstanding, basic and diluted	26,057,200	26,057,200	26,057,200	26,057,200

**SEE NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

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**BLUE HOLDINGS INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (UNAUDITED)**  
**FOR THE SIX MONTHS ENDED JUNE 30, 2007**

	Shares Issued Number	Par Value 0.001	Additional Paid In Capital	Accumulated Deficit	Total
Balance, January 1, 2007	26,057,200	\$ 26,057	\$ 4,964,091	\$ (1,746,733)	\$ 3,243,415
Fair value of vested stock options	-	-	137,747	-	137,747
Cumulative effect of adoption of FIN 48	-	-	-	(52,465)	(52,465)
Fair value of stock issued under co-branding agreement	175,000	175	227,325	-	227,500
Net Income for the period	-	-	-	124,494	124,494
Balance, June 30, 2007	26,232,200	\$ 26,232	\$ 5,329,163	\$ (1,674,704)	\$ 3,680,691

**SEE NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

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**BLUE HOLDINGS INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**  
**FOR THE SIX MONTHS ENDED JUNE 30, 2007 AND 2006**

	Six Months Ended June 30,	
	2007	2006
Cash flows from operating activities:		
Net Income	\$ 124,494	\$ 2,394,672
Adjustments to reconcile net income to cash used in operating activities:		
Depreciation and amortization	187,679	77,470
Fair value of vested stock options	137,747	229,198
Changes in assets and liabilities:		
Accounts receivable	1,015,687	(4,994,324)
Due from factor	127,547	(69,905)
Income taxes receivable	14,044	-
Inventories	(3,067,458)	(3,350,545)
Due to related parties	(584,419)	666,026
Due from related parties	-	15,974
Deferred income taxes	81,586	(365,071)
Prepaid expenses and other current assets	(684,220)	(183,178)
Income tax payable	-	176,055
Bank overdraft	544,985	(616,020)
Accounts payable	(1,345,241)	730,153
Other current liabilities	(459,163)	(75,012)
Net cash used in operating activities	(3,906,732)	(5,364,507)
Cash flows from investing activities:		
Purchase of equipment	(224,530)	(364,837)
Deferred acquisition costs	-	(236,619)
Net cash used in investing activities	(224,530)	(601,456)
Cash flows from financing activities:		
Short-term borrowings	4,042,625	3,423,169
Advances from majority shareholder	164,125	2,422,231
Net cash provided by financing activities	4,206,750	5,845,400
Net (decrease) increase in cash	75,488	(120,563)
Cash at beginning of period	109,031	228,127
<b>Cash at end of period</b>	<b>\$ 184,519</b>	<b>\$ 107,564</b>
<b>SUPPLEMENTAL CASH FLOW INFORMATION:</b>		
Cash paid for income tax	\$ 12,866	\$ 1,855,200
Cash paid for interest	\$ 752,533	\$ 385,762



**SUPPLEMENTAL DISCLOSURE OF NON-CASH FINANCING AND INVESTING ACTIVITIES:**

Cumulative effect of adoption of FIN 48	\$	52,465	\$	-
Increase in prepaids for fair value of stock issued under co-branding agreement	\$	227,500	\$	-

**SEE NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

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BLUE HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
AS OF JUNE 30, 2007 (UNAUDITED)

**NOTE 1 – BASIS OF PRESENTATION, ORGANIZATION AND NATURE OF OPERATIONS**

**(a) Basis of Presentation**

The interim condensed consolidated financial statements are unaudited, but in the opinion of management of the Company, contain all adjustments, which include normal recurring adjustments, necessary to present fairly the financial position at June 30, 2007 and the results of operations for the three and six months ended June 30, 2007 and 2006 and cash flow for the six months ended June 30, 2007 and 2006. The condensed consolidated balance sheet as of December 31, 2006 is derived from the Company's audited financial statements.

Certain information and footnote disclosures normally included in financial statements that have been presented in accordance with generally accepted accounting principles have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission with respect to interim financial statements, although management of the Company believes that the disclosures contained in these financial statements are adequate to make the information presented therein not misleading. For further information, refer to the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-KSB for the fiscal year ended December 31, 2006, as filed with the Securities and Exchange Commission.

The Company's results of operations for the three and six months ended June 30, 2007 are not necessarily indicative of the results of operations to be expected for the full fiscal year ending December 31, 2007.

The condensed consolidated financial statements include the operations of Blue Holdings, Inc. and its wholly-owned subsidiaries. Intercompany transactions and balances are eliminated in consolidation.

**(b) Organization**

Blue Holdings, Inc. (the "Company") was incorporated in the State of Nevada on February 9, 2000 under the name Marine Jet Technology Corp. On April 14, 2005, Blue Holdings entered into an Exchange Agreement with Antik Denim, LLC ("Antik"). At the closing of the transactions contemplated by the Exchange Agreement, which occurred on April 29, 2005, Blue Holdings acquired all of the outstanding membership interests of Antik (the "Interests") from the members of Antik, and the members contributed all of their Interests to Blue Holdings. In exchange, Blue Holdings issued to the members 843,027 shares of Series A Convertible Preferred Stock, par value \$0.001 per share, of Blue Holdings ("Preferred Shares"), which, on June 7, 2005, as a result of a change to Marine Jet Technology Corp.'s name to Blue Holdings, Inc. and a 1 for 29 reverse stock split, were converted into 24,447,783 shares of Blue Holding's common stock on a post-reverse stock split basis.

As such, immediately following the closing and upon the conversion of the Preferred Shares, the Antik members and Elizabeth Guez, our former Chief Operating Officer and wife of Paul Guez, owned approximately 95.8% of the total issued and outstanding common stock of Blue Holdings on a fully-diluted basis. Following completion of the exchange transaction, Antik became a wholly-owned subsidiary of Blue Holdings. The acquisition was accounted for as a reverse merger (recapitalization) in the accompanying financial statements with Antik deemed to be the accounting acquirer and Blue Holdings deemed to be the legal acquirer. As such, the financial statements herein include those of Antik since September 13, 2004 (the date of its inception). All assets and liabilities of Marine Jet

Technology Corp. were assumed by the major shareholder of Blue Holdings, Inc. prior to the exchange transaction and were inconsequential to the merged companies.

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BLUE HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
AS OF JUNE 30, 2007 (UNAUDITED)

On June 7, 2005, Marine Jet Technology Corp. changed its name to Blue Holdings, Inc., and increased its authorized number of shares of common stock to 75,000,000.

On October 31, 2005, the Company entered into an exchange agreement with Taverniti So Jeans, LLC, a California limited liability company (“Taverniti”), and the members of Taverniti (the “Taverniti Members”). Under the exchange agreement, the Company acquired all of the outstanding membership interests of Taverniti (the “Taverniti Interests”) from the Taverniti Members, and the Taverniti Members contributed all of their Taverniti Interests to the Company. In exchange, the Company issued to the Taverniti Members, on a pro rata basis, an aggregate of 500,000 shares of the Common Stock, par value \$0.001 per share, of the Company, and paid to the Taverniti Members, on a pro rata basis, an aggregate of Seven Hundred Fifty Thousand Dollars (\$750,000). At the closing of the exchange transaction, Taverniti became a wholly-owned subsidiary of the Company. Paul Guez, the Company’s Chairman and majority shareholder, was and remains the sole manager and was a member of Taverniti. Elizabeth Guez, Paul Guez’s spouse and the Company’s former Chief Operating Officer, was also a member of Taverniti. Two other members of Mr. and Mrs. Guez’s family were the remaining members of Taverniti. The transaction was accounted for as a combination of entities under common control. As such, the financial statements herein have been presented to include the operations of Taverniti since September 13, 2004, the date of its inception, and the \$750,000 payment was considered as a deemed distribution to the members of Taverniti upon the closing of the combination.

**(c) Nature of Operations**

The Company operates exclusively in the wholesale apparel industry. The Company designs, develops, markets and distributes high fashion jeans and accessories under the brand names *Antik Denim*, *Yanuk*, *U*, *Faith Connexion* and *Taverniti So Jeans*. The Company’s products currently include jeans, jackets, belts, purses and T-shirts. The Company is currently looking into integrating *Life & Death* as one of its brands. The Company currently sells its products in the United States, Canada, Japan and the European Union directly to department stores and boutiques and through distribution arrangements in certain foreign jurisdictions. The Company is headquartered in Commerce, California and maintains showrooms in New York and Los Angeles. The Company opened a retail store in Los Angeles during August 2005 and another store in San Francisco in September 2006. These retail operations are not yet significant to the consolidated operations.

**NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**(a) Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues. On an ongoing basis, we evaluate estimates, including those related to returns, discounts, bad debts, inventories, intangible assets, income taxes, contingencies and litigation. We base our estimates on historical experience and on various assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.



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BLUE HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
AS OF JUNE 30, 2007 (UNAUDITED)

**(b) Revenue Recognition**

Revenue is recognized when merchandise has been shipped against a customer's written purchase order, the risk of ownership has passed, selling price has been fixed and determined and collectibility is reasonably assured either through payment received, or fulfillment of all the terms and conditions of the particular purchase order. Revenue is recorded net of estimated returns, charge backs and markdowns based on management's estimates and historical experience.

**(c) Advertising**

Advertising costs are expensed as of the first date the advertisements take place. Advertising expenses included in selling expenses approximated \$57,652 and \$119,574 for the three and six months ended June 30, 2007, respectively, as compared with \$69,897 and \$576,062 for the same respective periods last year.

**(d) Shipping and Handling Costs**

Freight charges are included in selling, distribution and administrative expenses in the statement of operations and approximated \$149,960 and \$297,235 for the three and six months ended June 30, 2007, respectively, as compared to \$156,145 and \$324,791 for the same respective periods in the prior year.

**(e) Major Suppliers**

We purchase our fabric, thread and other raw materials from various industry suppliers within the United States and abroad. We do not currently have any long-term agreements in place for the supply of our fabric, thread or other raw materials. The fabric, thread and other raw materials used by us are available from a large number of suppliers worldwide. During the three months ended June 30, 2007, only one supplier accounted for more than 10% of our purchases. Purchases from that supplier were 25.4%. During the six months ended June 30, 2007, three suppliers accounted for more than 10% of our purchases and purchases from these suppliers were 18.3%, 11.1% and 10.1%, respectively. During fiscal 2006, three suppliers accounted for more than 10% of our purchases. Purchases from these suppliers were 19.7%, 14.9% and 10.2% for the three months ended June 30, 2006, and 13.9%, 11% and 10.9% for the six months ended June 30, 2006, respectively.

**(f) Major Customers**

During fiscal 2007, two customers accounted for more than 10% of the Company's sales. Sales to those customers were 13.5% and 10.3%, respectively, for the three months ended June 30, 2007, and 11.6% and 10.4%, respectively, for the six months ended June 30, 2007. During the three months ended June 30 2006, two customers accounted for more than 10% of the Company's sales. Sales to those customers were 15% and 11%, respectively. During the six months ended June 30, 2006, one customer accounted for 16% of the Company's total sales.

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## BLUE HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
AS OF JUNE 30, 2007 (UNAUDITED)

International sales accounted for approximately 17.9% and 21.6% of the Company's sales during the three and six months ended June 30, 2007, respectively, including Japan which accounted for 11.5% and 13.3%, respectively, of our total sales.

International sales accounted for approximately 23% and 29% of sales in the three and six months ended June 30, 2006, respectively, including Japan which accounted for 13.2% and 18.5%, respectively, of our total sales.

As of June 30, 2007 and December 31, 2006, one customer accounted for 34% and 42% of total accounts receivable, respectively.

**(g) Stock-Based Compensation**

In December 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards 123R, "Share-Based Payment" ("SFAS 123R"). This statement requires that the cost resulting from all share-based payment transactions be recognized in the financial statements. This statement establishes fair value as the measurement objective in accounting for share-based payment arrangements and requires all entities to apply a fair-value based measurement method in accounting for share-based payment transactions with employees except for equity instruments held by employee share ownership plans. Effective January 1, 2006, the Company adopted the fair value recognition provisions of SFAS 123R, using the modified prospective method. Under this method, the provisions of SFAS 123R apply to all awards granted or modified after the date of adoption and all previously granted awards not yet vested as of the date of adoption.

The fair value of options was estimated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions for the three months ended June 30, 2007 and 2006:

	June 30, 2007	June 30, 2006
Dividend yield	—	—
Risk-free interest rate	4.50%	4.50%
Expected volatility	46.01%	46.01%
Expected life of options	5 years	5 years

**(h) Earnings per Share**

Statement of Financial Accounting Standards No. 128, "Earnings per Share," requires presentation of basic earnings per share ("Basic EPS") and diluted earnings per share ("Diluted EPS"). Basic earnings (loss) per share are computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflects the potential dilution, using the treasury stock method, that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Company. In computing diluted earnings per share, the treasury stock method assumes that outstanding options and warrants are exercised and the proceeds are used to purchase common stock at the average market price during the period. Options and warrants will have a dilutive effect under

the treasury stock method only when the average market price of the common stock during the period exceeds the exercise price of the options and warrants.

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BLUE HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
AS OF JUNE 30, 2007 (UNAUDITED)

At June 30, 2007 and 2006, potentially dilutive securities consisted of outstanding common stock options to acquire 489,500 and 685,000 shares, respectively. These potentially dilutive securities were not included in the calculation of loss per share for the quarter ended June 30, 2007 as they are insignificant to the calculation. Accordingly, basic and diluted earnings per share for each of the three and six months ended June 30, 2007 and 2006 are the same.

Issued but unvested shares of common stock under forfeitable service agreements are excluded from the calculations of basic and diluted earnings per share until such shares are earned.

**(i) Reclassifications**

Certain prior year balance sheet items have been reclassified to conform to the current period presentation.

**(j) Adoption of new accounting policy**

Effective January 1, 2007, the Company adopted Financial Accounting Standards Board Interpretation No. 48, "Accounting for Uncertainty in Income Taxes ("FIN 48")—an interpretation of FASB Statement No. 109, Accounting for Income Taxes." The Interpretation addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under FIN 48, we may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement. FIN 48 also provides guidance on derecognition, classification, interest and penalties on income taxes, accounting in interim periods and requires increased disclosures. At the date of adoption, and as of June 30, 2007, the Company made a cumulative effect adjustment. See note 8.

The Company files income tax returns in the U.S. federal jurisdiction and various states. The Company is subject to U.S. federal or state income tax examinations by tax authorities for years after 2002. The Company's tax returns are currently under examination by the government. As of June 30, 2007, the taxing authorities have not proposed any significant adjustments to taxable income. The Company does not expect to receive any adjustments that would result in a material change to its final position.

The Company's policy is to record interest and penalties on uncertain tax provisions as income tax expense. See note 8.

**(k) Recent accounting pronouncements**

In February 2007, the Financial Accounting Standards Board (FASB) issued FASB Statement No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities — including an amendment of FASB Statement No. 115" (FAS 159). FAS 159, which becomes effective for the company on January 1, 2008, permits companies to choose to measure many financial instruments and certain other items at fair value and report unrealized gains and losses in earnings. Such accounting is optional and is generally to be applied instrument by instrument. The company does not anticipate that election, if any, of this fair-value option will have a material effect on its consolidated financial condition, results of operations, cash flows or disclosures.



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BLUE HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
AS OF JUNE 30, 2007 (UNAUDITED)

In September 2006, the FASB issued FAS No. 157 (“FAS 157”), “Fair Value Measurements,” which establishes a framework for measuring fair value in accordance with GAAP and expands disclosures about fair value measurements. FAS 157 does not require any new fair value measurements but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements. FAS 157 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact this standard will have on its consolidated financial condition, results of operations, cash flows or disclosures.

**NOTE 3 – DUE FROM FACTOR**

We use a factor for working capital and credit administration purposes. Under the various factoring agreements entered into separately by Blue Holdings, Antik and Taverniti, the factor purchases all the trade accounts receivable assigned by the Company and its subsidiaries and assumes all credit risk with respect to those accounts approved by it.

The factor agreements provide that we can borrow an amount up to 90% of the value of our purchased customer invoices, less a reserve of 10% of unpaid accounts purchased and 100% of all such accounts which are disputed. The factor agreements provide for automatic renewal subject to 120 days’ termination notice from any party. The factor also makes available to all three companies a combined line of credit up to the lesser of \$2.4 million or 50% of the value of eligible raw materials and finished goods. As of June 30, 2007, the Company drew down \$2.4 million of this credit line against inventory, \$6.4 million against accounts receivable and \$5.3 million against personal guarantees of Paul Guez, our Chairman and majority shareholder, and the living trust of Paul and Elizabeth Guez.

As of June 30, 2007, the factor holds \$2,012,054 of accounts receivable purchased from us on a without recourse basis and has made advances to us of \$587,597 against those receivables, resulting in a net balance amount Due from Factor of \$1,239,041, net of reserves of \$185,417, as of June 30, 2007. The Company has accounted for the sale of receivables to the factor in accordance with SFAS No. 140, “Accounting for the Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.”

As of June 30, 2007, the factor also held as collateral \$6,279,254 of accounts receivable that were subject to recourse, against which the Company has provided reserves of \$1,029,938 and as of June 30, 2007, the Company received advances totaling \$14,069,439 against such receivables and against eligible inventory. The Company has included the \$6,279,254 in accounts receivable, and has reflected the \$14,069,439 as short term borrowings on the accompanying balance sheet. The factor commission against such receivables is 0.4% and interest is charged at the rate of 1% over the factor’s prime lending rate per annum.

The factor commission on receivables purchased on a without recourse basis is 0.75% if the aggregate amount of approved invoices is below \$10 million per annum, 0.70% if between \$10 million and \$20 million and 0.65% if between \$20 million and \$30 million. The Company is contingently liable to the factor for merchandise disputes, customer claims and the like on receivables sold to the factor. To the extent that the Company draws funds prior to the deemed collection date of the accounts receivable sold to the factor, interest is charged at the rate of 1% over the factor’s prime lending rate per annum. Factor advances are collateralized by the non-factored accounts receivable, inventories and the personal guarantees of Paul Guez, our Chairman and majority shareholder, and the living trust of Paul and Elizabeth Guez.



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## BLUE HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
AS OF JUNE 30, 2007 (UNAUDITED)**NOTE 4 - INVENTORIES**

Inventories at June 30, 2007 and December 31, 2006 are summarized as follows:

	June 30, 2007	December 31, 2006
Raw Materials	\$ 3,383,495	\$ 3,583,019
Work-in-Process	1,930,260	991,775
Finished Goods	4,178,364	2,562,105
	\$ 9,492,119	\$ 7,136,899
Less: Inventory valuation allowance	(1,030,655)	(1,742,893)
<b>TOTAL</b>	<b>\$ 8,461,464</b>	<b>\$ 5,394,006</b>

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## BLUE HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
AS OF JUNE 30, 2007 (UNAUDITED)**NOTE 5 - PROPERTY AND EQUIPMENT**

Property and equipment at June 30, 2007 and December 31, 2006 are summarized as follows:

	June 30, 2007	December 31, 2006
Furniture	\$ 20,782	\$ 14,294
Leasehold Improvements	1,293,277	1,219,094
Computer Equipment	760,752	616,551
	2,074,811	1,849,939
Less: Accumulated depreciation and Amortization	(426,789)	(238,768)
	\$ 1,648,022	\$ 1,611,171

Depreciation expense for the three months ended June 30, 2007 and 2006 was \$97,078 and \$51,450, respectively and for the six months ended June 30, 2007 and 2006 was \$187,679 and \$77,470, respectively.

**NOTE 6 - RELATED PARTY TRANSACTIONS**

The Company purchased fabric at cost from Blue Concept, LLC which is owned by Paul Guez, the Company's Chairman, for \$97,680 and \$183,302 during the three and six months ended June 30, 2007, respectively, and \$10,092 and \$251,658, respectively, during the same periods in the prior year.

On January 1, 2006, the Company leased its facility at Commerce, California from Azteca Production International Inc., as a sub-tenant and is paying it \$19,030 per month. Azteca is a company that is co-owned by Paul Guez. Rent expense includes \$57,090 and \$114,180, respectively, for three and six months June 30, 2007, paid under this lease.

On July 5, 2005 the Company entered into a ten-year license agreement with Yanuk Jeans, LLC. Under the terms of the agreement, the Company became the exclusive licensor for the design, development, manufacture, sale, marketing and distribution of the *Yanuk* brand products to the wholesale and retail trade. The Company pays to Yanuk Jeans, LLC a royalty of six percent of all net sales of the licensed products and a guaranteed minimum royalty on an annual basis. In addition, during the term of the license agreement, the Company has the option to purchase from Yanuk Jeans, LLC the property licensed under the agreement. The royalties paid and payable for the three and six months ended June 30, 2006, were \$68,312 and \$182,931, respectively. Yanuk has agreed to waive such royalties due for the three and six months ended June 30, 2007, and has agreed to waive such royalties through December 31, 2008. Yanuk Jeans, LLC is solely owned by Paul Guez.

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BLUE HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
AS OF JUNE 30, 2007 (UNAUDITED)

On October 6, 2005, the Company entered into a five-year license agreement with Yanuk Jeans, LLC. Under the terms of the agreement, the Company became the exclusive licensor for the design, development, manufacture, sale, marketing and distribution of Yanuk Jeans, LLC's *U* brand products to the wholesale and retail trade. The Company pays to Yanuk Jeans, LLC a royalty of five percent of all net sales of the licensed products and shall pay a guaranteed minimum royalty on an annual basis. In addition, during the term of the license agreement, the Company has the option to purchase from Yanuk Jeans, LLC the property licensed under the agreement. The royalties for the three and six months ended June 30, 2007 paid or payable to Yanuk Jeans, LLC for the *U* brand products was \$0 and \$0, respectively and \$0 and \$0, respectively, for the same period last year.

Paul Guez and the living trust of Paul and Elizabeth Guez have guaranteed all advances and ledger debt due to the Company's factor.

On August 27, 2005, the Company opened a retail store on Melrose Avenue, Los Angeles, California and took over all the obligations of a 10-year property lease which was entered into by Blue Concept, LLC in April 2005. The lease will expire on March 15, 2015.

Taverniti is the exclusive licensee for the design, development, manufacture, sale, marketing and distribution of the *Taverniti So Jeans* trademark in the denim and knit sports wear categories for men and women. It is paying royalties to Taverniti Holdings, LLC in the ranges of 5-8 percent depending on the net sales of the licensed products pursuant to a license agreement with Taverniti Holdings, LLC. Taverniti Holdings, LLC is jointly owned by Paul Guez (60%) and Jimmy Taverniti (40%), the designer of the products for the brand, and Mr. Guez is the sole manager. The license agreement was signed in May 2004 and expires on December 31, 2015. Royalties paid or payable for the three months ended June 30, 2007 and 2006 were \$86,420 and \$305,744, respectively, and \$211,757 and \$656,526 for the six months ended June 30, 2007 and 2006, respectively.

**NOTE 7 - DUE FROM/TO RELATED PARTIES**

The related parties are the Company's majority shareholder (who is also the Chairman, Chief Executive Officer and President of the Company) and limited liability companies that are either owned or co-owned by the majority shareholder. These amounts are all unsecured and non-interest bearing. All non-trade related advances from related parties have been repaid. Trade-related outstanding items follow regular payment terms as invoiced. As of June 30, 2007 and December 31, 2006, total trade-related items due to related parties amounted to \$125,734 and \$710,153, respectively.

From time to time, the Company's majority shareholder, Mr. Paul Guez, made advances to the Company to support its working capital needs. These advances were non-interest bearing and unsecured, with no formal terms of repayment. On July 1, 2006, Mr. Guez converted the advances to a line of credit in an agreement with the Company. The line of credit allows the Company to borrow from him up to a maximum of \$3 million at an interest rate of 6% per annum. The Company may repay the advances in full or in part at any time until the credit line expires and repayment is required, on December 31, 2007. As of June 30, 2007 and December 31, 2006, the balance of these advances was \$2,041,116 and \$1,876,991 respectively, and accrued interest thereon was \$67,501 and \$0, respectively. Interest expense includes \$35,490 and \$0, for three months ended June 30, 2007 and 2006, respectively, and \$67,501 and \$0, for six months ended June 30, 2007 and 2006, respectively.





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## BLUE HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
AS OF JUNE 30, 2007 (UNAUDITED)**NOTE 8 - INCOME TAX**

The Company accounts for income taxes and the related accounts under the liability method. Deferred tax liabilities and assets are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted rates expected to be in effect during the year in which the basis differences reverse.

The Company's provision for income taxes was \$108,916 for the six months ended June 30, 2007 compared to \$1,674,095 for the same period of the prior year.

The provision for income taxes consists of the following for the periods ended June 30:

	2007	2006
Current		
Federal	\$ (28,411)	\$ 1,464,225
State	15,157	436,649
Deferred		
Federal	106,254	(188,416)
State	15,916	(38,363)
Provision for income tax expense	\$ 108,916	\$ 1,674,095

A reconciliation of the statutory federal income tax rate to the effective tax rate is as follows for the periods ended June 30:

	2007	2006
Statutory federal rate	34.00%	34.00%
State taxes, net of federal benefit	5.50	6.50
Permanent differences	4.80	0.00
Unrecognized tax benefits	2.40	0.00
Other	0	0.6
Effective tax rate	46.70%	41.10%

The Company and its subsidiaries files income tax returns in the U.S. federal jurisdiction and various state jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal or state and local income tax examinations by tax authorities for years before 2002. The Internal Revenue Service (IRS) commenced an examination of the Company's U.S. income tax return for 2005 in the first quarter of 2007 that is anticipated to be completed by the end of 2007. As of June 30, 2007, the IRS has not proposed any adjustments.

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## BLUE HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
AS OF JUNE 30, 2007 (UNAUDITED)

The Company adopted the provisions of FASB Interpretation No.48, Accounting for Uncertainty in Income Taxes, on January 1, 2007. As a result of the implementation of Interpretation 48, the Company recognized a \$32,288 increase in the liability for unrecognized tax benefits, which was accounted for as a reduction to the January 1, 2007 balance of retained earnings. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

Balance at January 1, 2007	\$ 310,458
Additions based on tax positions related to the current year	-
Additions for tax positions of prior years	9,300
Reductions for tax positions of prior years	-
Settlements	(52,024)
Balance	\$ 267,734

Included in the balance at June 30, 2007 are \$208,966 of tax positions for which the ultimate deductibility is highly certain but for which there is uncertainty about the timing of such deductibility. Because of the impact of deferred tax accounting, other than interest and penalties, the disallowance of the shorter deductibility period would not affect the annual effective tax rate but would accelerate the payment of cash to the taxing authority to an earlier period.

The Company recognizes accrued interest and penalties related to unrecognized tax benefits in income tax expense. During the period ended June 30, 2007, the Company recognized in income tax expense \$9,300 for interest and penalties. The Company included in its balance for unrecognized tax benefits at June 30, 2007 \$70,789 for the payment of interest and penalties.

**NOTE 9 – STOCK OPTIONS**

Under the Company's 2005 Stock Incentive Plan (the "Company Plan"), the Company may grant qualified and nonqualified stock options and stock purchase rights to selected employees. The Company reserved 2,500,000 shares of common stock for issuance under the Company Plan.

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## BLUE HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
AS OF JUNE 30, 2007 (UNAUDITED)

At June 30, 2007, options outstanding are as follows:

	Number of options	Weighted average exercise price	Intrinsic Value
Balance at January 1, 2007	335,500	\$ 5.75	-
Granted	300,000	\$ 1.98	-
Exercised	-	-	-
Cancelled	(146,000)	\$ 5.20	-
Balance at December 31, 2006	489,500	\$ 3.48	-

Additional information regarding options outstanding as of June 30, 2007 is as follows:

Exercise price	Options outstanding			Options exercisable		
	Number outstanding	Weighted average remaining contractual life (years)	Weighted average exercise price	Number exercisable	Weighted average exercise price	
\$ 8.10	42,000	7.68	\$ 8.10	22,000	\$ 8.10	
\$ 5.30	33,500	8.12	\$ 5.30	33,500	\$ 5.30	
\$ 5.20	114,000	8.50	\$ 5.20	35,500	\$ 5.20	
\$ 1.98	300,000	9.75	\$ 1.98	100,000	\$ 1.98	
5.20 - \$ 8.10	489,500	9.17	\$ 3.48	191,000	\$ 3.87	

Stock based compensation expense of \$137,747 and \$229,198 were recognized during the six months ended June 30, 2007 and 2006, respectively, relating to the vesting of such options. As of June 30, 2007, the unamortized value of these option awards were \$346,865 which will be amortized as a stock based compensation cost over the average of approximately three years as the options vest.

**NOTE 10 – CO-BRANDING AGREEMENT**

On May 11, 2007, the Company entered into a Letter of Intent with William Adams, aka will.i.am, of the Black Eyed Peas, pursuant to which the parties agreed to, within 30 days of the date of execution, enter into (i) a co-branding agreement for the creation of a collection of premium denim and denim-related apparel under the name “i.am Antik” or such other similar name upon which the parties shall agree, and (ii) a joint venture agreement pursuant to which the parties will design, develop, market, manufacture and distribute apparel products bearing the “I.Am” trademark subject to a license agreement. The term of each of the co-branding agreement and the joint venture agreement shall be for five years, with the first year commencing on the execution of the Letter of Intent and ending on the last day of

February 2008, and each year thereafter commencing on March 1 and ending on the last day of February. Prior to their entry into the Letter of Intent, the parties had no material relationship with each other. The Letter of Intent was effective May 11, 2007 and was approved and certified by the shareholders of the Company on June 21, 2007.

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BLUE HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
AS OF JUNE 30, 2007 (UNAUDITED)

Mr. Adams is required to perform specific design, marketing and promotional services under the term of Letter of Intent. In consideration of such services rendered by Mr. Adams, the Company issued to Mr. Adams as base compensation 175,000 shares of its common stock on May 21, 2007 and will issue to Mr. Adams 81,250 shares on each anniversary of the effective date of the Letter of Intent for a period of 4 years, subject to the prior effectiveness of a registration statement on Form S-8 registering the issuance of the shares to Mr. Adams. Mr. Adams will also be entitled to receive up to an aggregate of 500,000 additional shares of common stock from the Company upon achieving certain milestones based on net sales.

Mr. Adams is permitted to terminate the co-branding agreement and/or joint venture agreement in the event that the Company is delisted from the NASDAQ Capital Market, a final and binding legal determination is made by a body with appropriate jurisdiction that the Company has failed to comply with the rules and regulations promulgated by the Securities and Exchange Commission, or the joint venture's failure to launch an "I.Am" collection within 12 months from the date of execution of the definitive joint venture agreement.

The Company determined that since the shares contain performance requirements and specific services to be performed, and the shares would be returned if such services were not performed, it is appropriate to recognize as expense the value of the issued shares that are earned each month. As such, the Company determined that the 175,000 shares that were issued in May 2007 will be amortized as earned over a one year period. The shares earned will be valued at the end of each month based on the fair value of those shares in accordance with EITF 96-18. Compensation expense for the six months ended June 30, 2007 amounted to \$6,300 based upon the amortization of the shares earned from June 21, 2007, the revised effective date of the agreement.

**NOTE 11 – COMMITMENTS AND CONTINGENCIES**

**License agreements:**

On January 12, 2007, the Company entered into a License Agreement with Faith Connexion S.A.R.L., a company formed under the laws of France ("Faith"). Pursuant to the License Agreement, Faith granted an exclusive right and license to use the *Faith Connexion* trademark for the manufacture, marketing, promotion, sale, distribution and other exploitation of men's and women's hoodies, t-shirts, sweatshirts, sweatpants and hats in North America (including Canada), South America, Japan and Korea. Compensation for use of the *Faith Connexion* trademark will consist of a royalty calculated as 9% of the Company's net sales arising from products bearing the *Faith Connexion* trademark in the first two years, and 9.5% of net sales in year three. The License Agreement has a term of three years as follows: the first year is comprised of 18 months, year two is comprised of the next six months, and year three is comprised of the following 12 months. Per the agreement, the Company has agreed to a guarantee payment of royalties on identified minimum net sales amounts ranging from \$3.5 to \$10 million over each of the three years (equal to minimum royalties of \$450,000, \$315,000, and \$950,000, in each of years one (first eighteen months), two (next 6 months) and three (next twelve months), respectively, and to spend at least 3% of actual net sales amounts on marketing and advertising the *Faith Connexion* trademarked products in the territory. During three months ended June 30, 2007, the Company recorded royalty expense of \$75,000.

On April 27, 2007, Antik Denim, LLC ("Antik"), a California limited liability company and our wholly-owned subsidiary, executed a License Agreement (the "Mercier License Agreement") dated to be effective as of April 18, 2007, by and between Antik and Mercier SARL, a company formed under the laws of France ("Mercier").



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BLUE HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
AS OF JUNE 30, 2007 (UNAUDITED)

Pursuant to the Mercier License Agreement, Antik granted an exclusive right and license to use the *Antik Denim* trademark for the manufacture, marketing, promotion, sale, distribution and other exploitation of denim and sportswear apparel in Europe. Compensation for use of the *Antik Denim* trademark will consist of a royalty calculated as 10% of Mercier's net sales arising from products bearing the *Antik Denim* trademark. The Mercier License Agreement has an initial term of twenty (20) months, and includes four (4) one (1)-year extension options available to Mercier to the extent it achieves specified minimum net sales. Mercier has agreed to guarantee payment of royalties on an identified minimum net sales amount of \$2.5 million during the initial twenty (20) month term, and on identified minimum net sales amounts ranging from \$2.5 million to \$10 million over the eligible extension terms. In connection with these minimum net sales, the Mercier License Agreement provides for an upfront minimum guarantee advance of \$250,000 which has been received by the Company and recorded as a deferred revenue as of June 30, 2007, and an aggregate of minimum royalty payments of \$2.5 million for the years 2009 through 2012 assuming the Mercier License Agreement is renewed at the end of 2008.

On April 27, 2007, in anticipation of Antik's entry into the Mercier License Agreement, Antik executed Amendment No. 1 to License Agreement (the "Amendment"), dated to be effective as of April 25, 2007, by and between Antik and North Star, LLC ("North Star"). The sole purpose of the Amendment was to remove the European territory from the rights previously granted to North Star.

On May 1, 2007, Antik executed a License Agreement (the "Max Ray License Agreement") dated to be effective as of May 1, 2007, by and between Antik and Max Ray, Inc., a California corporation ("Max Ray"). Pursuant to the Max Ray License Agreement, Antik granted an exclusive right and license to use the *Antik Denim* trademark for the manufacture, marketing, promotion, sale, distribution and other exploitation of small leather goods consisting of belts, handbags, small leather accessories and scarves in the United States and its territories. Compensation for use of the *Antik Denim* trademark will consist of a royalty calculated as 8% of Max Ray's net sales arising from products bearing the *Antik Denim* trademark. The Max Ray License Agreement has an initial term of eighteen (18) months, and includes four (4) one (1)-year extension options available to Max Ray unless earlier terminated by Max Ray. Max Ray has agreed to guarantee payment of royalties on an identified minimum net sales amount of \$1.1 million during the initial eighteen (18) month term, and on identified minimum net sales amounts ranging from \$3 million to \$10 million over the eligible extension terms. In connection with these minimum net sales, the Max Ray License Agreement provides for an upfront minimum guarantee advance of \$20,000 to be applied against the minimum guaranty for the aggregate initial term, and an aggregate of minimum royalty payments of \$2.1 million for the years 2009 through 2012 assuming the Max Ray License Agreement is renewed at the end of 2008.

**Legal proceedings:**

On July 17, 2006, Taverniti Holdings, LLC (THL), an independent entity not owned or controlled by us, and Jimmy Taverniti, an individual, filed an action in the United States District Court for the Central District of California (Case No. CV06-4522 DDP) against Henri Levy alleging that defendant has infringed THL's mark J. TAVERNITI and further infringed Mr. Taverniti's commercial publicity rights, by defendant's adoption and use of the mark TAVERNITY. We have been informed that in a counter-claim against THL, defendant has also named our company and Taverniti as purported counter defendants. As it relates to Taverniti and our company, the counter claim seeks only a declaration of rights, to the effect that Taverniti and our company have conspired with THL to defeat defendant's alleged rights in his TAVERNITY mark, and a further declaration that as a result of such alleged misconduct, neither Taverniti nor our company have any enforceable rights in the TAVERNITI SO JEANS mark. It

does not seek any monetary relief against either Taverniti or our company.

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BLUE HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
AS OF JUNE 30, 2007 (UNAUDITED)

We have taken the position that neither Taverniti nor our company can properly be added as new parties to this lawsuit by naming us as counter defendants, and that we can only be named as third party defendants. The defendant has not, as yet, served either Taverniti or us with the counter claim, and so we are not yet formally parties to the case. At such time, if ever, that the defendant takes the necessary action to formally serve us with the counter claim, we intend to deny all the material charging allegations of the defendant's claim for declaratory relief and to vigorously defend against his claims. At this time, we are unable to express an opinion whether it is likely that the defendant will take such actions, or whether, if he does, it is likely or unlikely that he will be able to prevail against us on his claim for declaratory relief.

**NOTE 12-SUBSEQUENT EVENTS**

On July 24, 2007, the Company appointed Glenn S. Palmer as its new Chief Executive Officer and President. The Employment Agreement is effective as of July 1, 2007 and will terminate on December 31, 2009. Under the terms of the Employment Agreement, Mr. Palmer will receive base compensation for each of the third and fourth quarters of fiscal 2007 of \$87,500 and minimum annual compensation for each of fiscal 2008 and 2009 of \$400,000. Mr. Palmer is also entitled to receive an annual bonus equivalent to 2.5% of the Company's earnings before interest, taxes, depreciation and amortization for each of the years ended December 31, 2008 and 2009, and is eligible to receive a bonus for the period ended December 31, 2007, if any, as determined by the Compensation Committee of the Company's Board of Directors. Mr. Palmer is also entitled to four weeks paid vacation and reimbursement of expenses, including up to \$2,000 per month for all expenses incurred by Mr. Palmer with respect to his personal automobile. The Company has also agreed to provide Mr. Palmer with a furnished apartment or comparable living space in Los Angeles, California suitable to his position for the initial twelve months of the term of the Employment Agreement. Additionally, the Company has agreed to pay for no more than two coach or economy class round trip tickets per month from Los Angeles to New Jersey for Mr. Palmer. As an inducement material to Mr. Palmer's decision to enter into employment with the Company, the Company agreed to grant Mr. Palmer an option to purchase 625,000 shares of the Company's common stock. The option has a term of 10 years, a per share exercise price of \$1.40 and will vest over a period of two years, with 125,000 shares vesting on the date of grant and 125,000 shares vesting on each subsequent six-month anniversary of the date of grant. All unexercised options outstanding as of the date of any termination of Mr. Palmer's employment with the Registrant will expire.

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**ITEM MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS  
2. OF OPERATIONS**

Forward-Looking Statements

Statements made in this Form 10-Q (the "Quarterly Report") that are not historical or current facts are "forward-looking statements" made pursuant to the safe harbor provisions of Section 27A of the Securities Act of 1933, as amended (the "Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). We intend that such forward-looking statements be subject to the safe harbors for such statements. We wish to caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made. Any forward-looking statements represent management's best judgment as to what may occur in the future. The forward-looking statements included herein are based on current expectations that involve numerous risks and uncertainties. Assumptions relating to the foregoing involve judgments with respect to, among other things, future economic, competitive and market conditions and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond our control. Although we believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could be inaccurate and, therefore, there can be no assurance that the forward-looking statements included in this Quarterly Report will prove to be accurate. In light of the significant uncertainties inherent in the forward-looking statements included herein, the inclusion of such information should not be regarded as a representation by us or any other person that our objectives and plans will be achieved. We disclaim any obligation subsequently to revise any forward-looking statements to reflect events or circumstances after the date of such statement or to reflect the occurrence of anticipated or unanticipated events.

The words "we," "us," "our," and the "Company," refer to Blue Holdings, Inc. The words or phrases "may," "will," "expect," "believe," "anticipate," "estimate," "approximate," or "continue," "would be," "will allow," "intends to," "will likely result," "will continue," "is anticipated," "estimate," "project," or similar expressions, or the negative thereof, are intended to identify "forward-looking statements." Actual results could differ materially from those projected in the forward looking statements as a result of a number of risks and uncertainties, including but not limited to: (a) our failure to implement our business plan within the time period we originally planned to accomplish; and (b) other risks that are discussed in this Quarterly Report or included in our previous filings with the Securities and Exchange Commission ("SEC").

Description of Business

Overview

Blue Holdings, Inc. designs, develops, markets and distributes high end fashion jeans, apparel and accessories under the brand name names *Antik Denim*, *Yanuk*, *U*, *Faith Connexion* and *Taverniti So Jeans*. We plan to also design, develop, market and distribute jeans and accessories under other brands that we may license or acquire from time to time. We are currently looking into integrating *Life & Death* as one of our brands. Our products currently include jeans, jackets, belts, purses and T-shirts. We currently sell our products in the United States, Canada, Japan and the European Union directly to department stores and boutiques and through distribution arrangements in certain foreign jurisdictions. We are headquartered in Commerce, California and maintain two showrooms in New York and Los Angeles. We opened a retail store in Los Angeles during August 2005 and another in San Francisco in September 2006.

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Corporate Background

We were incorporated in the State of Nevada on February 9, 2000 under the name Marine Jet Technology Corp. From our inception through January 2005, we focused on developing and marketing boat propulsion technology. Between January and February 2005, we entered into separate transactions whereby, among other matters, Keating Reverse Merger Fund, LLC (“KRM Fund”), an existing shareholder of the Company, agreed to purchase a substantial majority of our outstanding common stock, and Intellijet Marine, Inc., a company formed by our former majority shareholder and principal executive officer and director, Jeff P. Jordan, acquired all of our boat propulsion technology assets and assumed all of our then existing liabilities.

Between February 4, 2005 and April 29, 2005, we existed as a public “shell” company with nominal assets.

Significant Developments in Second Quarter

On January 12, 2007, we entered into a three-year License Agreement (the “Faith License Agreement”) with Faith Connexion S.A.R.L. (“Faith”) pursuant to which Faith granted us an exclusive right and license to use the *Faith Connexion* trademark for the manufacture, marketing, promotion, sale, distribution and other exploitation of men’s and women’s hoodies, t-shirts, sweatshirts, sweatpants and hats in North America, South America, Japan and Korea. Compensation for use of the *Faith Connexion* trademark will consist of a royalty of 9% of our net sales arising from products bearing the *Faith Connexion* trademark in the first two years, and 9.5% of net sales in year three. The Faith License Agreement has a term of three years as follows: the first year is comprised of 18 months, year two is comprised of the next six months, and year three is comprised of the following 12 months. We have agreed to guarantee payment of royalties on identified minimum net sales amounts ranging from \$3.5 to \$10 million over each of the three years (equal to minimum royalties of \$450,000, \$315,000, and \$950,000, in each of years one (first eighteen months), two (next 6 months) and three (next twelve months), respectively, and to spend at least 3% of actual net sales amounts on marketing and advertising the *Faith Connexion* trademarked products in the territory. During the quarter ended June 30, 2007, we recorded royalty expense of \$75,000 pursuant to the minimum guaranteed royalty.

In March 2007, the United States Internal Revenue Service initiated an examination of our Federal income tax return for the year ended December 31, 2005. As of June 30, 2007, the taxing authorities have not proposed any significant adjustments to taxable income. We do not expect to receive any adjustments that would result in a material change to our final position.

In March 2007, we appointed Scott J. Drake as our President of Sales and Chief Operating Officer. Mr. Drake has over 25 years of experience in the apparel business.

On April 27, 2007, Antik Denim, LLC (“Antik”), a California limited liability company and our wholly-owned subsidiary, executed a License Agreement (the “Mercier License Agreement”) dated to be effective as of April 18, 2007, by and between Antik and Mercier SARL, a company formed under the laws of France (“Mercier”).

Pursuant to the Mercier License Agreement, Antik granted an exclusive right and license to use the *Antik Denim* trademark for the manufacture, marketing, promotion, sale, distribution and other exploitation of denim and sportswear apparel in Europe. Compensation for use of the *Antik Denim* trademark will consist of a royalty calculated as 10% of Mercier’s net sales arising from products bearing the *Antik Denim* trademark. The Mercier License Agreement has an initial term of twenty (20) months, and includes four (4) one (1)-year extension options available to Mercier to the extent it achieves specified minimum net sales. Mercier has agreed to guarantee payment of royalties on an identified minimum net sales amount of \$2.5 million during the initial twenty (20) month term, and on identified minimum net sales amounts ranging from \$2.5 million to \$10 million over the eligible extension terms. In connection with these minimum net sales, the Mercier License Agreement provides for an upfront minimum guarantee advance of

\$250,000 which has been received by the Company and recorded as a deferred revenue as of June 30, 2007, and an aggregate of minimum royalty payments of \$2.5 million for the years 2009 through 2012 assuming the Mercier License Agreement is renewed at the end of 2008.

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On April 27, 2007, in anticipation of Antik's entry into the Mercier License Agreement, Antik executed Amendment No. 1 to License Agreement (the "Amendment"), dated to be effective as of April 25, 2007, by and between Antik and North Star, LLC ("North Star"). The sole purpose of the Amendment was to remove the European territory from the rights previously granted to North Star.

On May 1, 2007, Antik executed a License Agreement (the "Max Ray License Agreement") dated to be effective as of May 1, 2007, by and between Antik and Max Ray, Inc., a California corporation ("Max Ray"). Pursuant to the Max Ray License Agreement, Antik granted an exclusive right and license to use the *Antik Denim* trademark for the manufacture, marketing, promotion, sale, distribution and other exploitation of small leather goods consisting of belts, handbags, small leather accessories and scarves in the United States and its territories. Compensation for use of the *Antik Denim* trademark will consist of a royalty calculated as 8% of Max Ray's net sales arising from products bearing the *Antik Denim* trademark. The Max Ray License Agreement has an initial term of eighteen (18) months, and includes four (4) one (1)-year extension options available to Max Ray unless earlier terminated by Max Ray. Max Ray has agreed to guarantee payment of royalties on an identified minimum net sales amount of \$1.1 million during the initial eighteen (18) month term, and on identified minimum net sales amounts ranging from \$3 million to \$10 million over the eligible extension terms. In connection with these minimum net sales, the Max Ray License Agreement provides for an upfront minimum guarantee advance of \$20,000 to be applied against the minimum guaranty for the aggregate initial term, and an aggregate of minimum royalty payments of \$2.1 million for the years 2009 through 2012 assuming the Max Ray License Agreement is renewed at the end of 2008.

Subsequent Significant Developments

On July 24, 2007, we appointed Glenn S. Palmer as our new Chief Executive Officer and President. Mr. Palmer's Employment Agreement is effective as of July 1, 2007 and will terminate on December 31, 2009. Under the terms of the Employment Agreement, Mr. Palmer will receive base compensation for each of the third and fourth quarters of fiscal 2007 of \$87,500 and minimum annual compensation for each of fiscal 2008 and 2009 of \$400,000. Mr. Palmer is also entitled to receive an annual bonus equivalent to 2.5% of our earnings before interest, taxes, depreciation and amortization for each of the years ended December 31, 2008 and 2009, and is eligible to receive a bonus for the period ended December 31, 2007, if any, as determined by the Compensation Committee of our Board of Directors. Mr. Palmer is also entitled to four weeks paid vacation and reimbursement of expenses, including up to \$2,000 per month for all expenses incurred by Mr. Palmer with respect to his personal automobile. We have also agreed to provide Mr. Palmer with a furnished apartment or comparable living space in Los Angeles, California suitable to his position for the initial twelve months of the term of the Employment Agreement. Additionally, we have agreed to pay for no more than two coach or economy class round trip tickets per month from Los Angeles to New Jersey for Mr. Palmer. As an inducement material to Mr. Palmer's decision to enter into employment with us, we agreed to grant Mr. Palmer an option to purchase 625,000 shares of our common stock. The option has a term of 10 years, a per share exercise price of \$1.40 and will vest over a period of two years, with 125,000 shares vesting on the date of grant and 125,000 shares vesting on each subsequent six-month anniversary of the date of grant. All unexercised options outstanding as of the date of any termination of Mr. Palmer's employment with us will expire.

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Mr. Palmer has commenced the implementation of a comprehensive action plan with key strategic initiatives focused on cutting costs to reduce our SG&A by approximately 10% by the end of the year, selling off our excess inventory, and aggressively reviewing and evaluating the long-term viability of our brands, licensees and retail strategy.

**Results of Operations**

The following table sets forth, for the periods indicated, certain data derived from our consolidated statements of operations and certain such data expressed as a percentage of net sales.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Net Sales	\$ 8,401,971	\$ 15,180,652	\$ 16,842,193	\$ 27,058,531
Gross Profit	4,491,141	7,428,353	9,563,602	13,377,616
Percentage of net sales	53%	49%	57%	49%
Selling, distribution & administrative expenses	\$ 4,057,091	\$ 4,322,680	\$ 8,577,659	\$ 8,923,087
Percentage of net sales	48%	28%	51%	33%
Income before provision for income taxes	\$ 19,661	\$ 2,891,224	\$ 233,410	\$ 4,068,767
Percentage of net sales	0%	19%	1%	15%
Net income	\$ 7,236	\$ 1,714,496	\$ 124,494	\$ 2,394,672
Percentage of net sales	0%	11%	1%	9%

**Three Months Ended June 30, 2007 vs. 2006**

Net sales decreased from \$15.2 million for the three months ended June 30, 2006 to \$8.4 million for the three months ended June 30, 2007. The sales were less than during the same period last year for a variety of reasons. Firstly, due to the lack of European distributors, our international sales reduced from 23% during the three months ended June 30, 2006 to 17.9% during three months ended June 30, 2007. Secondly, we are still recovering from our third and fourth quarter delivery problems. During the latter part of the second quarter of 2007, several major retailers re-established their sales orders with us. In addition, in May 2007, we signed a European license agreement.

Gross profit for the three months ended June 30, 2007 decreased to \$4.49 million from \$7.43 million in the three months ended June 30, 2006. The decrease in gross profit was largely due to reduced sales during the quarter ended June 30, 2007. However, we expect our gross margin to be maintained at approximately 50% in the future.

Selling, distribution and administrative expenses for the three months ended June 30, 2007 totaled \$4.06 million compared with \$4.32 million for the three months ended June 30, 2006. The principal components in the second quarter of 2007 were payroll of \$1.7 million (compared to \$1.7 million in the second quarter last year), rent expense of \$0.30 million (\$0.12 million in the same period of 2006), professional fee expenses of \$0.26 million (\$0.3 million in the same period of 2006), royalties of \$0.16 million (\$0.37 million in 2006) and stock-based compensation of \$0.08 million (\$0.11 million in the same period last year).

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Net Income after provision for taxes in the second quarter of 2007 was \$0.01 million or 0.1% of net sales compared to \$1.7 million or 11% of net sales in the second quarter of 2006. Basic and diluted earnings per share decreased to \$0.00 from \$0.07 in the same period of last year. For the three months ended June 30, 2007, the Company provided \$0.01 million for income tax compared to \$1.18 million for the three months ended June 30, 2006.

**Six Months Ended June 30, 2007 vs. 2006**

Net sales decreased from \$27.1 million for the six months ended June 30, 2006 to \$16.8 million for the six months ended June 30, 2007. The sales were less than during the same period last year for a variety of reasons. First, due to the lack of European distributors, our international sales decreased from 29% in 2006 to 21.6% during the six months ended June 30, 2007. Secondly, we are still recovering from our third and fourth quarter delivery problems. However, in the latter part of the second quarter of 2007, several major retailers re-established their sales orders with us. In addition, in May 2007, we signed a European license agreement.

Gross profit for the six months ended June 30, 2007 decreased to \$9.56 million from \$13.38 million during the same period last year. The decrease in gross profit was largely due to reduced sales during the six months ended June 30, 2007. However, we expect our gross margin to be maintained at approximately 50% in the future.

Selling, distribution and administrative expenses for the six months ended June 30, 2007 totaled \$8.58 million compared with \$8.92 million for the same period last year. The principal components during the six months ended June 30, 2007 were payroll of \$3.4 million (compared to \$3.5 million in the same period last year), professional fee expenses of \$0.65 million (\$0.58 million in the same period of 2006), advertising and trade show expenses of \$0.55 million (\$0.71 million in the same period of 2006), rent expense of \$0.47 million (\$0.37 million in the same period of 2006), royalties of \$0.36 million (\$0.83 million in 2006) and stock-based compensation of \$0.14 million (\$0.23 million in the same period last year).

Net Income after provision for taxes during the six months ended June 30, 2007 was \$0.1 million or 1% of net sales compared to \$2.39 million or 8.9% of net sales during the same period of 2006. Basic and diluted earnings per share decreased to \$0.00 from \$0.09 in the same period of last year. For the six months ended June 30, 2007, the Company provided \$0.1 million for income tax compared to \$1.67 million for the six months ended June 30, 2006.

**Liquidity and Capital Resources**

We believe we currently have adequate resources to fund our anticipated cash needs through December 31, 2007 and beyond. However, an adverse business development could require us to raise additional financing sooner than anticipated.

For the six months ended June 30, 2007, net cash used in operating activities was \$(3.9 million). The deficit was primarily due to an increase of \$3.1 million in inventory and \$0.7 million in prepaid and other current assets and a decrease in accounts payable of \$1.3 million and was offset by a decrease in accounts receivables of \$1.0 million, and an increase in bank overdraft of \$0.5 million. Net cash provided by financing activities was \$4.2 million due to an increase in short-term borrowings by \$4.0 million and an increase in advances from our majority shareholder by \$0.2 million.

We use a factor, FTC Commercial Corp., for working capital and credit administration purposes. Under the various factoring agreements entered into separately by Blue Holdings, Antik and Taverniti So Jeans, LLC ("Taverniti"), the factor purchases all the trade accounts receivable assigned by us and assumes all credit risk with respect to those accounts approved by it.





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The factor agreements provide that we can obtain an amount up to 90% of the value of our purchased customer invoices, less a reserve of 10% of unpaid accounts purchased and 100% of all accounts that are disputed. The factor agreements provide for the automatic renewal of the agreements subject to 120 days' termination notice from any party. We receive amounts against purchased customer invoices on a recourse basis or a non-recourse basis under these agreements. Amounts received against customer invoices purchased on a recourse basis are classified as "short-term borrowings" and amounts received against customer invoices purchased on a non-recourse basis are reflected on a net basis against such receivables purchased by the factor in "due from factor" on the balance sheets included in our financial statements.

In addition, the factor also makes available to all three companies a combined line of credit up to the lesser of \$2.4 million and 50% of the value of eligible raw materials and finished goods. As of June 30, 2007, we drew down \$2.4 million of this credit line.

As of June 30, 2007, the amount of the reserve held by the factor was approximately \$1.2 million. The factor commission is 0.75% if the aggregate amount of approved invoices is below \$10 million per annum, and will be reduced by 5 basis points for each increase by \$10 million in the aggregate amount of approved invoices. We are contingently liable to the factor for merchandise disputes, customer claims and the like on receivables sold to the factor. To the extent that we draw funds prior to the deemed collection date of the accounts receivable sold to the factor, interest is charged at the rate of 1% over the factor's prime lending rate per annum. Factor advances and ledger debt are collateralized by the non-factored accounts receivable, inventories and the personal guarantees of Paul Guez, our Chairman of the Board of Directors and majority shareholder, and the living trust of Paul and Elizabeth Guez.

The factor also purchased customer invoices on a "with recourse" basis. These advances and the advances against inventory were classified as "short-term borrowings." These short-term borrowings amounted to \$14.1 million as of June 30, 2007. The factor commission is 0.4% for receivables purchased subject to recourse. Receivables subject to recourse approximated \$6.4 million net of reserves as of June 30, 2007. Although the arrangement with our factor is important to our liquidity and capital resources, management believes that cash flow from operations, and our ability to obtain other debt or equity financing, permits us to adequately support and manage our ongoing operations.

From time to time, our majority shareholder, Mr. Paul Guez, made advances to us to support our working capital needs. These advances were non-interest bearing. On July 1, 2006, Mr. Guez converted the advances to a line of credit in an agreement with us. The line of credit allows us to borrow from him up to a maximum of \$3 million at an annual interest rate of 6%. We may repay the advances in full or in part at any time until the credit line expires on December 31, 2007. As of June 30, 2007, the balance of these advances was \$2.0 million.

Our primary source of liquidity is expected to be cash flow generated from operations, cash and cash equivalents currently on hand, and working capital attainable through our factor. We received a \$1.45 million tax refund during the third quarter of 2007. We may seek to finance future capital needs through various means and channels, such as issuance of long-term debt or sale of equity securities.

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*Critical Accounting Policies*

*Estimates*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues. On an ongoing basis, we evaluate estimates, including those related to returns, discounts, bad debts, inventories, intangible assets, income taxes, contingencies and litigations. We base our estimates on historical experience and on various assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

*Revenue*

Revenue is recognized when merchandise has been shipped against a customer's written purchase order, the risk of ownership has passed, selling price has been fixed and determined and collectibility is reasonably assured either through payment received, or fulfillment of all the terms and conditions of the particular purchase order. Revenue is recorded net of estimated returns, charge backs and markdowns based on management's estimates and historical experience.

*Accounts Receivable - Allowance for Returns, Discounts and Bad Debts:*

We evaluate our ability to collect accounts receivable and the circumstances surrounding chargebacks (disputes from the customer) based upon a combination of factors. In circumstances where we are aware of a specific customer's inability to meet its financial obligations (such as in the case of bankruptcy filings or substantial downgrading by credit sources), a specific reserve for bad debts is taken against amounts due to reduce the net recognized receivable to the amount reasonably expected to be collected. For all other customers, we recognize reserves for bad debts and uncollectible chargebacks based on our historical collection experience. If our collection experience deteriorates (for example, due to an unexpected material adverse change in a major customer's ability to meet its financial obligations to us), the estimates of the recoverability of amounts due could be reduced by a material amount.

*Inventories*

Inventories are stated at the lower of cost or market. Cost is determined on the first-in, first-out ("FIFO") method.

*Income Taxes*

We account for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes." Under SFAS No. 109, income taxes are recognized for the amount of taxes payable or refundable for the current year and deferred tax liabilities and assets are recognized for the future tax consequences of transactions that have been recognized in our financial statements or tax returns. A valuation allowance is provided when it is more likely than not that some portion or all of the deferred tax asset will not be realized.

At the beginning of fiscal year 2007, we adopted the provisions of FASB Interpretation No.48, "Accounting for Uncertainty in Income Taxes." As a result of the implementation of Interpretation 48, we recognized a \$52,465 increase in the liability for unrecognized tax benefits, which was accounted for as a reduction to the January 1, 2007 balance of retained earnings.



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**Recent Accounting Pronouncements and Developments**

In February 2007, the Financial Accounting Standards Board (FASB) issued FASB Statement No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities — Including an amendment of FASB Statement No. 115” (FAS 159). FAS 159, which becomes effective for the company on January 1, 2008, permits companies to choose to measure many financial instruments and certain other items at fair value and report unrealized gains and losses in earnings. Such accounting is optional and is generally to be applied instrument by instrument. The company does not anticipate that election, if any, of this fair-value option will have a material effect on its consolidated financial condition, results of operations, cash flows or disclosures.

In September 2006, the FASB issued FAS No. 157 (“FAS 157”), “Fair Value Measurements,” which establishes a framework for measuring fair value in accordance with GAAP and expands disclosures about fair value measurements. FAS 157 does not require any new fair value measurements but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements. FAS 157 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact this standard will have on its consolidated financial condition, results of operations, cash flows or disclosures.

**Off-Balance Sheet Arrangements**

Financial instruments that potentially subject the Company to off-balance sheet risk consist of factored accounts receivable. The Company sells certain of its trade accounts receivable to a factor and is contingently liable to the factor for merchandise disputes and other customer claims.

As of June 30, 2007, the factor holds \$2,012,054 of accounts receivable purchased from us on a without recourse basis and has made advances to us of \$587,597 against those receivables, resulting in a net balance amount Due from Factor of \$1,239,041, net of reserves of \$185,417, as of June 30, 2007. The Company has accounted for the sale of receivables to the factor in accordance with SFAS No. 140, “Accounting for the Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.”

**RISK FACTORS**

YOU SHOULD CAREFULLY CONSIDER THE FOLLOWING RISK FACTORS AND ALL OTHER INFORMATION CONTAINED IN THIS DESCRIPTION BEFORE PURCHASING SHARES OF OUR COMMON STOCK OR OTHER SECURITIES. INVESTING IN BLUE HOLDINGS’ COMMON STOCK INVOLVES A HIGH DEGREE OF RISK. THE RISKS AND UNCERTAINTIES DESCRIBED BELOW ARE NOT THE ONLY ONES FACING US. ADDITIONAL RISKS AND UNCERTAINTIES THAT WE ARE NOT AWARE OF, OR THAT WE CURRENTLY DEEM IMMATERIAL, ALSO MAY BECOME IMPORTANT FACTORS THAT AFFECT US. IF ANY OF THE FOLLOWING EVENTS OR OUTCOMES ACTUALLY OCCURS, OUR BUSINESS, OPERATING RESULTS AND FINANCIAL CONDITION WOULD LIKELY SUFFER. AS A RESULT, THE TRADING PRICE OF OUR COMMON STOCK COULD DECLINE, AND YOU MAY LOSE ALL OR PART OF THE MONEY YOU PAID TO PURCHASE OUR COMMON STOCK.

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Risks Related to Our Business

*We have a limited operating history, making it difficult to evaluate whether we will operate profitably.*

Antik and Taverniti, our wholly-owned subsidiaries, were formed in September 2004 to design, develop, manufacture, market, distribute and sell high end fashion jeans, apparel and accessories. Further, L&D is a start-up operation and *Faith Connection*, although successful in Europe, is not fully tested in the United States. As a result, we do not have a meaningful historical record of sales and revenues nor an established business track record. While our management believes that we have an opportunity to be successful in the high end fashion jean market, there can be no assurance that we will be successful in accomplishing our business initiatives, or that we will achieve any significant level of revenues, or continue to recognize net income, from the sale of our products.

Unanticipated problems, expenses and delays are frequently encountered in increasing production and sales and developing new products, especially in the current stage of our business. Our ability to continue to successfully develop, produce and sell our products and to generate significant operating revenues will depend on our ability to, among other matters:

- successfully market, distribute and sell our products or enter into agreements with third parties to perform these functions on our behalf; and
- obtain the financing required to implement our business plan.

Given our limited operating history, our license agreements with Yanuk Jeans, LLC, our acquisition of Taverniti, and our lack of long-term sales history and other sources of revenue, there can be no assurance that we will be able to achieve any of our goals and develop a sufficiently large customer base to be profitable.

*We may require additional capital in the future.*

We may not be able to fund our future growth or react to competitive pressures if we lack sufficient funds. Currently, management believes we have sufficient cash on hand and cash available through our factor to fund existing operations for the foreseeable future. However, in the future, we may need to raise additional funds through equity or debt financings or collaborative relationships, including in the event that we lose our relationship with our factor. This additional funding may not be available or, if available, it may not be available on commercially reasonable terms. In addition, any additional funding may result in significant dilution to existing shareholders. If adequate funds are not available on commercially acceptable terms, we may be required to curtail our operations or obtain funds through collaborative partners that may require us to release material rights to our products.

*Failure to manage our growth and expansion could impair our business.*

Management believes that we are poised for reasonable growth in 2007. However, no assurance can be given that we will be successful in maintaining or increasing our sales in the future. Any future growth in sales will require additional working capital and may place a significant strain on our management, management information systems, inventory management, sourcing capability, distribution facilities and receivables management. Any disruption in our order processing, sourcing or distribution systems could cause orders to be shipped late, and under industry practices, retailers generally can cancel orders or refuse to accept goods due to late shipment. Such cancellations and returns would result in a reduction in revenue, increased administrative and shipping costs and a further burden on our distribution facilities.



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Additionally, we intend from time to time to open and/or license retail stores focusing on the *Antik Denim*, *Yanuk*, *Taverniti So Jeans* and other brands, and to acquire and/or license other businesses and brands, as applicable, as we deem appropriate. If we are unable to adequately manage our retail operations, or to properly integrate any business or brands we acquire and/or license, this could adversely affect our results of operation and financial condition.

*The loss of Paul Guez or our lead designers would have an adverse effect on our future development and could significantly impair our ability to achieve our business objectives.*

Our success is largely dependent upon the expertise and knowledge of our Chairman, Chief Executive Officer and President, Paul Guez, and our lead designers, and our ability to continue to hire and retain other key personnel. The loss of Mr. Guez, or any of our other key personnel, could have a material adverse effect on our business, development, financial condition, and operating results. We do not maintain “key person” life insurance on any of our management or key personnel, including Mr. Guez.

*We currently own or license, and operate, a limited number of principal brands. If we are unsuccessful in marketing and distributing those brands or in executing our other strategies, our results of operations and financial condition will be adversely affected.*

While our goal is to employ a multi-brand strategy that will ultimately diversify the fashion and other risks associated with reliance on a limited product line, we currently operate, directly and through our wholly-owned subsidiaries Antik and Taverniti, a limited number of principal brands, most of which are being operated pursuant to very recent license or acquisition agreements. If we are unable to successfully market and distribute our branded products, or if the recent popularity of premium denim brands decreases, or if we are unable to execute on our multi-brand strategy to acquire and/or license additional companies and/or brands, as applicable, identified by our management from time to time, our results of operations and financial condition will be adversely affected.

*Our operating results may fluctuate significantly.*

Management expects that we will experience substantial variations in our net sales and operating results from quarter to quarter. We believe that the factors which influence this variability of quarterly results include:

- the timing of our introduction of new product lines;
- the level of consumer acceptance of each new product line;
- general economic and industry conditions that affect consumer spending and retailer purchasing;
  - the availability of manufacturing capacity;
  - the seasonality of the markets in which we participate;
  - the timing of trade shows;
  - the product mix of customer orders;
- the timing of the placement or cancellation of customer orders;
  - the weather;

- transportation delays;



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- quotas and other regulatory matters;
- the occurrence of charge backs in excess of reserves; and
- the timing of expenditures in anticipation of increased sales and actions of competitors.

As a result of fluctuations in our revenue and operating expenses that may occur, management believes that period-to-period comparisons of our results of operations are not a good indication of our future performance. It is possible that in some future quarter or quarters, our operating results will be below the expectations of securities analysts or investors. In that case, our common stock price could fluctuate significantly or decline.

*The loss of business from any significant customer would affect our results of operations.*

We have one customer who accounted for approximately 34% of our total receivables at June 30, 2007 and one customer who accounted for 13.5% of our sales for the quarter ended June 30, 2007. A decrease in business from or loss of any significant customer would have a material adverse effect on our results of operations. Additionally, certain retailers, including some of our customers, have experienced in the past, and may experience in the future, financial difficulties, which increase the risk of extending credit to such retailers and the risk that financial failure will eliminate a customer entirely. These retailers have attempted to improve their own operating efficiencies by concentrating their purchasing power among a narrowing group of vendors. There can be no assurance that we will remain a preferred vendor for our existing customers. Further, there can be no assurance that our factor will approve the extension of credit to certain retail customers in the future. If a customer's credit is not approved by the factor, we could assume the collection risk on sales to the customer itself, require that the customer provide a letter of credit, or choose not to make sales to the customer.

*Our business is subject to risks associated with importing products.*

A portion of our import operations are subject to tariffs imposed on imported products and quotas imposed by trade agreements. In addition, the countries in which our products are imported may from time to time impose additional new duties, tariffs or other restrictions on their respective imports or adversely modify existing restrictions. Adverse changes in these import costs and restrictions, or our suppliers' failure to comply with customs or similar laws, could harm our business. We cannot assure that future trade agreements will not provide our competitors with an advantage over us, or increase our costs, either of which could have an adverse effect on our business and financial condition.

Our operations are also subject to the effects of international trade agreements and regulations such as the North American Free Trade Agreement, and the activities and regulations of the World Trade Organization. Generally, these trade agreements benefit our business by reducing or eliminating the duties assessed on products or other materials manufactured in a particular country. However, trade agreements can also impose requirements that adversely affect our business, such as limiting the countries from which we can purchase raw materials and setting duties or restrictions on products that may be imported into the United States from a particular country.

Our ability to import raw materials in a timely and cost-effective manner may also be affected by problems at ports or issues that otherwise affect transportation and warehousing providers, such as labor disputes. These problems could require us to locate alternative ports or warehousing providers to avoid disruption to our customers. These alternatives may not be available on short notice or could result in higher transit costs, which could have an adverse impact on our business and financial condition.

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*Our dependence on independent manufacturers and suppliers of raw materials reduces our ability to control the manufacturing process, which could harm our sales, reputation and overall profitability.*

We depend on independent contract manufacturers and suppliers of raw materials to secure a sufficient supply of raw materials and maintain sufficient manufacturing and shipping capacity in an environment characterized by declining prices, labor shortages, continuing cost pressure and increased demands for product innovation and speed-to-market. This dependence could subject us to difficulty in obtaining timely delivery of products of acceptable quality. In addition, a contractor's failure to ship products to us in a timely manner or to meet the required quality standards could cause us to miss the delivery date requirements of our customers. The failure to make timely deliveries may cause our customers to cancel orders, refuse to accept deliveries, impose non-compliance charges through invoice deductions or other charge-backs, demand reduced prices or reduce future orders, any of which could harm our sales, reputation and overall profitability.

We do not have long-term contracts with any of our independent contractors and any of these contractors may unilaterally terminate their relationship with us at any time. While management believes that there exists an adequate supply of contractors to provide products and services to us, to the extent we are not able to secure or maintain relationships with independent contractors that are able to fulfill our requirements, our business would be harmed.

We have initiated standards for our suppliers, and monitor our independent contractors' compliance with applicable labor laws, but we do not control our contractors or their labor practices. The violation of federal, state or foreign labor laws by one of our contractors could result in us being subject to fines and our goods that are manufactured in violation of such laws being seized or their sale in interstate commerce being prohibited. To date, we have not been subject to any sanctions that, individually or in the aggregate, have had a material adverse effect on our business, and we are not aware of any facts on which any such sanctions could be based. There can be no assurance, however, that in the future we will not be subject to sanctions as a result of violations of applicable labor laws by our contractors, or that such sanctions will not have a material adverse effect on our business and results of operations.

*We may not be able to adequately protect our intellectual property rights.*

The loss of or inability to enforce our trademarks or any of our other proprietary or licensed designs, patents, know-how and trade secrets could adversely affect our business. If any third party copies or otherwise gains access to our trademarks or other proprietary rights, or develops similar products independently, it may be costly to enforce our rights and we would not be able to compete as effectively. Additionally, the laws of foreign countries may provide inadequate protection of intellectual property rights, making it difficult to enforce such rights in those countries.

We may need to bring legal claims to enforce or protect our intellectual property rights. Any litigation, whether successful or unsuccessful, could result in substantial costs and diversions of resources. In addition, notwithstanding the rights we have secured in our intellectual property, third parties may bring claims against us alleging that we have infringed on their intellectual property rights or that our intellectual property rights are not valid. Any claims against us, with or without merit, could be time consuming and costly to defend or litigate and therefore could have an adverse affect on our business.

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*Our business is growing more international and can be disrupted by factors beyond our control.*

We have been reducing our reliance on domestic contractors and expanding our use of offshore manufacturers as a cost-effective means to produce our products. During the quarter ended June 30, 2007, we sourced a significant majority of our finished products from suppliers located outside the United States and we also continued to increase our purchase of fabrics outside the United States. In addition, we have been increasing our international sales of product primarily through our licensees and distributors.

As a result of our increasing international operations, we face the possibility of greater losses from a number of risks inherent in doing business in international markets and from a number of factors which are beyond our control. Such factors that could harm our results of operations and financial condition include, among other things:

- Political instability or acts of terrorism, which disrupt trade with the countries in which our contractors, suppliers or customers are located;
  - Local business practices that do not conform to legal or ethical guidelines;
- Adoption of additional or revised quotas, restrictions or regulations relating to imports or exports;
  - Additional or increased customs duties, tariffs, taxes and other charges on imports;
  - Significant fluctuations in the value of the dollar against foreign currencies;
  - Increased difficulty in protecting our intellectual property rights in foreign jurisdictions;
- Social, legal or economic instability in the foreign markets in which we do business, which could influence our ability to sell our products in these international markets; and
  - Restrictions on the transfer of funds between the United States and foreign jurisdictions.

Risks Related to Our Industry

*Our sales are heavily influenced by general economic cycles.*

Apparel is a cyclical industry that is heavily dependent upon the overall level of consumer spending. Purchases of apparel and related goods tend to be highly correlated with cycles in the disposable income of our consumers. Our customers anticipate and respond to adverse changes in economic conditions and uncertainty by reducing inventories and canceling orders. As a result, any substantial deterioration in general economic conditions, increases in interest rates, acts of war, terrorist or political events that diminish consumer spending and confidence in any of the regions in which we compete, could reduce our sales and adversely affect our business and financial condition.

*Our business is highly competitive and depends on consumer spending patterns.*

The apparel industry is highly competitive. We face a variety of competitive challenges including:

- anticipating and quickly responding to changing consumer demands;
- developing innovative, high-quality products in sizes and styles that appeal to consumers;

- competitively pricing our products and achieving customer perception of value; and
- the need to provide strong and effective marketing support.

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*We must successfully gauge fashion trends and changing consumer preferences to succeed.*

Our success is largely dependent upon our ability to gauge the fashion tastes of our customers and to provide merchandise that satisfies retail and customer demand in a timely manner. The apparel business fluctuates according to changes in consumer preferences dictated in part by fashion and season. To the extent we misjudge the market for our merchandise, our sales may be adversely affected. Our ability to anticipate and effectively respond to changing fashion trends depends in part on our ability to attract and retain key personnel in our design, merchandising and marketing staff. Competition for these personnel is intense, and we cannot be sure that we will be able to attract and retain a sufficient number of qualified personnel in future periods.

*Our business may be subject to seasonal trends resulting in fluctuations in our quarterly results, which could cause uncertainty about our future performance and harm our results of operations.*

In the experience of our management, operating results in the high end fashion denim industry have been subject to seasonal trends when measured on a quarterly basis. These trends are dependent on numerous factors, including:

- the markets in which we operate;
- holiday seasons;
- consumer demand;
- climate;
- economic conditions; and
- numerous other factors beyond our control.

Other Risks Related to our Stock

*Our sale of securities in any equity or debt financing could result in dilution to our shareholders and have a material adverse effect on our earnings.*

Any sale of shares by us in future private placement or other offerings could result in dilution to our existing shareholders as a direct result of our issuance of additional shares of our capital stock. In addition, our business strategy may include expansion through internal growth, by acquiring complementary businesses, by acquiring or licensing additional brands, or by establishing strategic relationships with targeted customers and suppliers. In order to do so, or to fund our other activities, we may issue additional equity securities that could dilute our shareholders' stock ownership. We may also assume additional debt and incur impairment losses related to goodwill and other tangible assets if we acquire another company and this could negatively impact our results of operations.

*Insiders own a significant portion of our common stock, which could limit our shareholders' ability to influence the outcome of key transactions.*

As of August 13, 2007, our executive officers and directors owned approximately 79% of the outstanding shares of our common stock. Paul Guez, our Chairman, and his spouse Elizabeth Guez collectively owned approximately 72% of the outstanding shares of our common stock at August 13, 2007. Accordingly, our executive officers and key personnel have the ability to affect the outcome of, or exert considerable influence over, all matters requiring shareholder approval, including the election and removal of directors and any change in control. This concentration of

ownership of our common stock could have the effect of delaying or preventing a change of control of us or otherwise discouraging or preventing a potential acquirer from attempting to obtain control of us. This, in turn, could have a negative effect on the market price of our common stock. It could also prevent our shareholders from realizing a premium over the market prices for their shares of common stock.

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*Our stock price has been volatile.*

Our common stock is quoted on the NASDAQ Capital Market, and there can be substantial volatility in the market price of our common stock. The market price of our common stock has been, and is likely to continue to be, subject to significant fluctuations due to a variety of factors, including quarterly variations in operating results, operating results which vary from the expectations of securities analysts and investors, changes in financial estimates, changes in market valuations of competitors, announcements by us or our competitors of a material nature, loss of one or more customers, additions or departures of key personnel, future sales of common stock and stock market price and volume fluctuations. In addition, general political and economic conditions such as a recession, or interest rate or currency rate fluctuations may adversely affect the market price of our common stock.

In addition, the stock market in general has experienced extreme price and volume fluctuations that have affected the market price of our common stock. Often, price fluctuations are unrelated to operating performance of the specific companies whose stock is affected. In the past, following periods of volatility in the market price of a company's stock, securities class action litigation has occurred against the issuing company. If we were subject to this type of litigation in the future, we could incur substantial costs and a diversion of our management's attention and resources, each of which could have a material adverse effect on our revenue and earnings. Any adverse determination in this type of litigation could also subject us to significant liabilities.

*Absence of dividends could reduce our attractiveness to investors.*

Some investors favor companies that pay dividends, particularly in general downturns in the stock market. We have not declared or paid any cash dividends on our common stock. We currently intend to retain any future earnings for funding growth, and we do not currently anticipate paying cash dividends on our common stock in the foreseeable future. Because we may not pay dividends, your return on an investment in our common stock likely depends on your selling such stock at a profit.

*Our Board is authorized to issue preferred stock, which may make it difficult for any party to acquire us and adversely affect the price of our common stock.*

Under our articles of incorporation, our Board of Directors has the power to authorize the issuance of up to 5,000,000 shares of preferred stock and to determine the price, rights, preferences, privileges and restrictions, including voting rights, of those shares without further vote or action by the shareholders. Accordingly, our Board of Directors may issue preferred stock with terms that could have preference over and adversely affect the rights of holders of our common stock.

The issuance of any preferred stock may:

- make it difficult for any party to acquire us, even though an acquisition might be beneficial to our stockholders;
- delay, defer or prevent a change in control of our company;
- discourage bids for the common stock at a premium over the market price of our common stock;

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- adversely affect the voting and other rights of the holders of our common stock; and
- discourage acquisition proposals or tender offers for our shares.

The provisions allowing the issuance of preferred stock could limit the price that investors might be willing to pay in the future for shares of our common stock.

**ITEM 3. QUANTATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We do not have material exposure to losses from market-rate sensitive instruments and have not invested in derivative financial instruments.

**ITEM 4. CONTROLS AND PROCEDURES**

As of June 30, 2007, the end of the period covered by this Quarterly Report on Form 10-Q, we conducted an evaluation, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act). Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that as of June 30, 2007, our disclosure controls and procedures were effective.

During the quarter ended June 30, 2007, there were no changes in the internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.



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**PART II**

**ITEM LEGAL PROCEEDINGS**

**1.**

Except as described below, we are not involved in any legal proceedings that require disclosure in this report.

On July 17, 2006, Taverniti Holdings, LLC (THL), an independent entity not owned or controlled by us, and Jimmy Taverniti, an individual, filed an action in the United States District Court for the Central District of California (Case No. CV06-4522 DDP) against Henri Levy alleging that defendant has infringed THL's mark J. TAVERNITI and further infringed Mr. Taverniti's commercial publicity rights, by defendant's adoption and use of the mark TAVERNITY. We have been informed that in a counter-claim against THL, defendant has also named our company and Taverniti as purported counter defendants. As it relates to Taverniti and our company, the counter claim seeks only a declaration of rights, to the effect that Taverniti and our company have conspired with THL to defeat defendant's alleged rights in his TAVERNITY mark, and a further declaration that as a result of such alleged misconduct, neither Taverniti nor our company have any enforceable rights in the TAVERNITI SO JEANS mark. It does not seek any monetary relief against either Taverniti or our company.

We have taken the position that neither Taverniti nor our company can properly be added as new parties to this lawsuit by naming us as counter defendants, and that we can only be named as third party defendants. The defendant has not, as yet, served either Taverniti or us with the counter claim, and so we are not yet formally parties to the case. At such time, if ever, that the defendant takes the necessary action to formally serve us with the counter claim, we intend to deny all the material charging allegations of the defendant's claim for declaratory relief and to vigorously defend against his claims. At this time, we are unable to express an opinion whether it is likely that the defendant will take such actions, or whether, if he does, it is likely or unlikely that he will be able to prevail against us on his claim for declaratory relief.

**ITEM 1A.**

**RISK FACTORS**

A restated description of the risk factors associated with our business is included under "Risk Factors" in "Management's Discussion and Analysis of Financial Condition and Results of Operations," contained in Item 2 of Part I of this report. This description includes any material changes to and supersedes the description of the risk factors associated with our business previously disclosed in our 2006 Annual Report on Form 10-KSB and is incorporated herein by reference.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

We held our Annual Meeting of Shareholders on June 21, 2007. At the Annual Meeting, there were 26,057,200 shares of our common stock entitled to vote, and 23,146,387 (88.8%) were represented at the meeting in person and by proxy. Immediately prior to and following the Annual Meeting, our board of directors was comprised of Paul Guez, Gary Freeman, Harry Haralambus, Leonard Hecht and Kevin Keating.

The following summarizes vote results for those matters submitted to our shareholders for action at the Annual Meeting:

1. Proposal to elect Messrs. Guez, Freeman, Haralambus, Hecht and Keating to serve as our directors for the ensuing year and until their successors have been elected and qualified.

Director

For

Withheld

Paul Guez	22,517,950	0
Gary Freeman	22,517,950	0
Harry Haralambus	22,517,950	0
Leonard Hecht	22,517,950	0
Kevin Keating	22,517,950	0

2. Proposal to ratify the selection of Weinberg & Company, P.A. as our independent public accountants for the fiscal year ending December 31, 2007.

<u>For</u>	<u>Against</u>	<u>Abstain</u>	<u>Broker</u> <u>Non-Votes</u>
22,513,226	10,280	6,720	0

3. Proposal to ratify and approve our entry on May 11, 2007, into a Letter of Intent with William Adams, our entry into the definitive agreements contemplated under the Letter of Intent, and the issuance of up to 1,000,000 shares of our common stock to Mr. Adams pursuant to the terms of the Letter of Intent and the definitive agreements contemplated thereunder.

<u>For</u>	<u>Against</u>	<u>Abstain</u>	<u>Broker</u> <u>Non-Votes</u>
18,976,262	4,833	214,610	0

**ITEM 6.**

**EXHIBITS**

See attached Exhibit Index.

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**SIGNATURES**

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**BLUE HOLDINGS, INC.**

Date: August 14, 2007

By: /s/ Larry Jacobs  
Larry Jacobs  
Chief Financial Officer and  
Secretary

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Exhibit Number	Description of Exhibit
10.1	Letter of Intent dated May 9, 2007 and effective May 11, 2007 between the Registrant and William Adams. Incorporated by reference to Appendix A of the Registrant's revised Definitive Proxy Statement filed with the Securities and Exchange Commission on June 1, 2007.
10.2	Letter Agreement dated May 30, 2007 and executed on June 12, 2007 between the Registrant and William Adams.
10.3	Employment Agreement dated July 24, 2007 and effective July 1, 2007, between the Registrant and Glenn S. Palmer. Incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on July 30, 2007.
<u>31.1</u>	Certification of Principal Executive Officer pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
<u>31.2</u>	Certification of Principal Financial Officer pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
<u>32.1</u>	Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
<u>32.2</u>	Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.