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BLUE HOLDINGS, INC.  
Form 10QSB  
November 14, 2006

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

FORM 10-QSB

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

FOR THE QUARTERLY PERIOD ENDED: SEPTEMBER 30, 2006

COMMISSION FILE NUMBER: 000-33297

BLUE HOLDINGS, INC.  
(Exact name of small business issuer 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  
(Issuer's telephone number)

Check whether the issuer: (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 shell company (as defined in Rule 12b-2 of the Exchange Act). YES  No

As of November 13, 2006, 26,057,200 shares of the registrant's common stock were outstanding.

Transitional Small Business Disclosure Format (Check One):

Yes  No

TABLE OF CONTENTS

Page  
----

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|         |   |    |
|---------|---|----|
| PART I  | Financial Information   |    |
| Item 1. | Financial Statements  |    |
|         | Condensed Consolidated Balance Sheets (Unaudited)                                     | 3  |
|         | Condensed Consolidated Statements of Operations (Unaudited)                           | 4  |
|         | Condensed Consolidated Statements of Shareholders' Equity (Unaudited)                 | 5  |
|         | Condensed Consolidated Statements of Cash Flows (Unaudited)                           | 6  |
|         | Notes to the Condensed Consolidated Financial Statements (Unaudited)                  | 7  |
| Item 2. | Management's Discussion and Analysis of Financial Condition and Results of Operations | 19 |
| Item 3. | Controls and Procedures   | 36 |
| PART II | Other Information   |    |
| Item 6. | Exhibits  | 37 |

2

|   |                       |                      |
|---|-----------------------|----------------------|
| PART I  |                       |                      |
| ITEM 1.   | FINANCIAL STATEMENTS  |                      |
| BLUE HOLDINGS INC. (FORMERLY KNOWN AS MARINE JET TECHNOLOGY CORP.)<br>AND SUBSIDIARIES<br>CONDENSED CONSOLIDATED BALANCE SHEETS<br>AS OF SEPTEMBER 30, 2006 AND DECEMBER 31, 2005 |                       |                      |
| ASSETS  | September 30,<br>2006 | December 31,<br>2005 |
|   | -----                 | -----                |
| Current assets:   | (Unaudited)           |                      |
| Cash .....  | \$ 122,065            | \$ 228,127           |
| Due from factor, net of reserves of \$50,655<br>and \$96,849, respectively .....  | 1,483,464             | 693,474              |
| Accounts receivable, net of reserves of<br>\$556,980 and \$484,421, respectively:   |                       |                      |
| - Purchased by factor with recourse .....   | 7,519,219             | 4,287,163            |
| - Others .....  | 369,068               | 2,504                |
| Due from related parties .....  | --                    | 15,974               |
| Inventories .....   | 13,554,453            | 9,925,162            |
| Deferred income taxes .....   | 646,047               | 492,574              |
| Prepaid expenses and other current assets .....   | 1,092,560             | 351,919              |
|   | -----                 | -----                |
| Total current assets .....  | 24,786,876            | 15,996,897           |
| Deferred income taxes .....   | 1,519,740             | 1,671,135            |
| Property and equipment, less accumulated  |                       |                      |

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|  |              |              |
|--|--------------|--------------|
| depreciation .....   | 1,278,346    | 198,927      |
|  | -----        | -----        |
| Total assets .....   | \$27,584,962 | \$17,866,959 |
|  | =====        | =====        |
| LIABILITIES AND EQUITY   |              |              |
| Current liabilities:   |              |              |
| Bank overdraft .....   | \$ 21,717    | \$ 616,020   |
| Accounts payable .....   | 3,465,348    | 2,911,598    |
| Short-term borrowings .....  | 9,495,943    | 4,583,936    |
| Due to related parties .....   | 772,261      | 372,311      |
| Advances from majority shareholder .....   | 2,508,900    | 96,875       |
| Income taxes payable .....   | --           | 650,468      |
| Accrued expenses and other current liabilities .....   | 1,187,213    | 599,166      |
|  | -----        | -----        |
| Total current liabilities  | 17,451,382   | 9,830,374    |
|  | -----        | -----        |
| Commitment and contingency   |              |              |
| Stockholders' equity:  |              |              |
| Common stock \$0.001 par value,<br>75,000,000 shares authorized,<br>26,057,200 shares issued and outstanding ..... | 26,057       | 26,057       |
| Additional paid-in capital .....   | 5,119,935    | 4,996,752    |
| Retained earnings .....  | 4,987,588    | 3,013,776    |
|  | -----        | -----        |
| Total stockholders' equity .....   | 10,133,580   | 8,036,585    |
|  | -----        | -----        |
| Total liabilities and stockholders' equity .....   | \$27,584,962 | \$17,866,959 |
|  | =====        | =====        |

SEE NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

3

BLUE HOLDINGS INC. (FORMERLY KNOWN AS MARINE JET TECHNOLOGY CORP.)  
AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)  
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2006 AND 2005

|                          | THREE MONTHS<br>ENDED<br>SEPTEMBER 30, |               |
|--------------------------|--|---------------|
|                          | 2006                                   | 2005          |
|                          | -----                                  | -----         |
| Net sales .....          | \$ 14,551,581                          | \$ 13,887,689 |
| Cost of goods sold ..... | 10,116,732                             | 6,927,774     |
|                          | -----                                  | -----         |
| Gross profit .....       | 4,434,849                              | 6,959,915     |

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|   |              |              |
|---|--------------|--------------|
| Selling, distribution & administrative expenses .....           | 4,281,467    | 3,264,457    |
|   | -----        | -----        |
| Income before other expenses and provision for income taxes ... | 153,382      | 3,695,458    |
|   | -----        | -----        |
| Other expenses:   |              |              |
| Interest expense .....  | 257,997      | 11,095       |
| Expenses relating to abandoned acquisition of Long Rap, Inc.    | 500,887      | --           |
| Expenses relating to exchange transaction .....                 | --           | 50,000       |
|   | -----        | -----        |
| Total other expenses .....                                      | 758,884      | 61,095       |
|   | -----        | -----        |
| Income (loss) before provision for income taxes .....           | (605,502)    | 3,634,363    |
| Provision (benefit) for income taxes .....                      | (184,642)    | 1,239,830    |
|   | -----        | -----        |
| Net income (loss) .....   | \$ (420,860) | \$ 2,394,533 |
|   | =====        | =====        |
| Net income (loss) per common share, basic and diluted .....     | \$ (0.02)    | \$ 0.09      |
|   | =====        | =====        |
| Weighted average shares outstanding, basic and diluted .....    | 26,057,200   | 26,057,200   |
|   | =====        | =====        |

SEE NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

4

BLUE HOLDINGS INC. (FORMERLY KNOWN AS MARINE JET TECHNOLOGY CORP.)  
AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (UNAUDITED)  
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2006

|   | Shares Issued |                    | Additional<br>Paid In<br>Capital | Retained<br>Earnings |
|---|---------------|--------------------|----------------------------------|----------------------|
|   | Number        | Par Value<br>0.001 |                                  |                      |
|   | -----         | -----              | -----                            | -----                |
| Balance, January 1, 2006 .....  | 26,057,200    | \$ 26,057          | \$ 4,996,752                     | \$ 3,013,776         |
| Fair value of options granted ....  | --            | --                 | 356,528                          | --                   |
| Adjustment to deferred tax benefit<br>arising from the 2005<br>acquisition of Taverniti ..... | --            | --                 | (233,345)                        | --                   |
| Net Income for the period .....   | --            | --                 | --                               | 1,973,812            |

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|                                   |            |           |              |              |
|-----------------------------------|------------|-----------|--------------|--------------|
| Balance, September 30, 2006 ..... | 26,057,200 | \$ 26,057 | \$ 5,119,935 | \$ 4,987,588 |
|                                   | =====      | =====     | =====        | =====        |

5

BLUE HOLDINGS INC. (FORMERLY KNOWN AS MARINE JET TECHNOLOGY CORP.)  
AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)  
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2006 AND 2005

|  | Nine Months Ended<br>September 30, |              |
|--|------------------------------------|--------------|
|  | 2006                               | 2005         |
| Cash flows from operating activities:  |                                    |              |
| Net Income .....   | \$ 1,973,812                       | \$ 3,883,403 |
| Adjustments to reconcile net income to cash<br>used in operating activities: |                                    |              |
| Depreciation and amortization .....  | 136,644                            | 9,642        |
| Stock based exchange transaction expense ....                                | --                                 | 177,617      |
| Fair value of vested stock options .....                                     | 356,528                            | --           |
| Changes in assets and liabilities:   |                                    |              |
| Accounts receivable .....  | (3,598,620)                        | (912,853)    |
| Due from factor .....  | (789,990)                          | (1,387,048)  |
| Inventories .....  | (3,629,291)                        | (6,016,091)  |
| Due from related parties .....   | 15,974                             | (209,924)    |
| Deferred income taxes .....  | (235,423)                          | (278,639)    |
| Due to related parties .....   | 399,950                            | 709,010      |
| Prepaid expenses and other current assets ...                                | (740,641)                          | (65,048)     |
| Income tax payable .....   | (650,468)                          | 1,658,873    |
| Bank overdraft .....   | (594,303)                          | --           |
| Accounts payable .....   | 553,751                            | 1,279,924    |
| Other current liabilities .....  | 588,046                            | 685,296      |
| Net cash used in operating activities .....                                  | (6,214,031)                        | (465,838)    |
| Cash flows from investing activities:  |                                    |              |
| Purchase of equipment .....  | (1,216,063)                        | (116,077)    |
| Net cash used in investing activities .....                                  | (1,216,063)                        | (116,077)    |
| Cash flows from financing activities:  |                                    |              |
| Short-term borrowings .....  | 4,912,007                          | --           |
| Additional paid in capital .....   | --                                 | 686,200      |
| Advances from majority shareholder .....                                     | 2,412,025                          | 237,134      |
| Net cash provided by financing activities .....                              | 7,324,032                          | 923,334      |
| Net (decrease) increase in cash .....  | (106,062)                          | 341,419      |
| Cash at beginning of period .....  | 228,127                            | 84,635       |
| CASH AT END OF PERIOD .....  | \$ 122,065                         | \$ 426,054   |

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|  | =====        | =====        |
|--|--------------|--------------|
| SUPPLEMENTAL CASH FLOW INFORMATION:  |              |              |
| Cash paid for income tax .....   | \$ 2,551,605 | \$ 800       |
|  | =====        | =====        |
| Cash paid for interest .....   | \$ 643,759   | \$ 18,683    |
|  | =====        | =====        |
| SUPPLEMENTAL DISCLOSURE OF NON-CASH<br>FINANCING AND INVESTING ACTIVITIES:             |              |              |
| Inventory contributed by a stockholder at<br>its historical cost .....                 | \$ --        | \$ 1,200,000 |
|  | =====        | =====        |
| Value of common stock issued for finders<br>fee relating to exchange transaction ..... | \$ --        | \$ 177,617   |
|  | =====        | =====        |
| Adjustment to deferred taxes relating to<br>the 2005 acquisition of Taverniti .....    | \$ 233,345   | \$ --        |
|  | =====        | =====        |

SEE NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

6

BLUE HOLDINGS INC. (FORMERLY KNOWN AS MARINE JET TECHNOLOGY CORP.)  
AND SUBSIDIARIES

NOTES TO CONDENSED FINANCIAL STATEMENTS AS OF SEPTEMBER 30, 2006  
(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 September 30, 2006, the results of operations for the three and nine months ended September 30, 2006 and 2005 and cash flow for nine months ended September 30, 2006 and 2005. The consolidated balance sheet as of December 31, 2005 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, 2005, as filed with the Securities and Exchange Commission.

The Company's results of operations for the three and nine months ended September 30, 2006 are not necessarily indicative of the results of operations to be expected for the full fiscal year ending December 31, 2006.

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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. (a Nevada corporation formerly known as Marine Jet Technology Corp.) was incorporated in the State of Nevada on February 9, 2000. 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.

7

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.

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, Chief Executive Officer, President 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, including Gregory Abbou, the President of Taverniti, were the remaining members of Taverniti. The transaction was accounted for as a combination of entities under common control. As such, the financial statements

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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", "Taverniti So Jeans", and "Yanuk". The Company's products currently include jeans, jackets, belts, purses and T-shirts. 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.

8

## 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.

### (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 \$51,420 and \$627,482 for the three and nine months ended September 30, 2006, respectively, compared to \$254,276 and \$324,442 for the three and nine months ended September 30, 2005, respectively.

### (d) CONCENTRATION OF CREDIT RISK



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Financial instruments, which potentially expose the Company to concentration of credit risk, consist primarily of cash, trade accounts receivable, and amounts due from our factor. With respect to trade accounts receivable at September 30, 2006, one customer comprised approximately 42% of our total receivables. The Company extends unsecured credit to its customers in the normal course of business.

The Company's cash balances on deposit with banks are guaranteed by the Federal Deposit Insurance Corporation up to \$100,000. The Company may be exposed to risk for the amounts of funds held in one bank in excess of the insurance limit. In assessing the risk, the Company's policy is to maintain cash balances with high quality financial institutions.

The Company's products are primarily sold to department stores and specialty retail stores. These customers can be significantly affected by changes in economic, competitive or other factors. The Company makes substantial sales to a relatively few, large customers. In order to minimize the risk of loss, the Company assigns certain amounts of domestic accounts receivable to a factor without recourse or requires letters of credit from its customers prior to the shipment of goods. For non-factored receivables, account-monitoring procedures are utilized to minimize the risk of loss. Collateral is generally not required.

9

### (e) SHIPPING AND HANDLING COSTS

Freight charges are included in selling, distribution and administrative expenses in the statement of operations and approximated \$263,861 and \$588,672 for the three and nine months ended September 30, 2006, respectively, compared to \$89,055 and \$168,279 for the same periods of 2005, respectively.

### (f) 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 September 30, 2006, three suppliers accounted for more than 10% of our purchases. Purchases from these suppliers were 31.5%, 13.0% and 11.8% respectively. During the nine months ended September 30, 2006, two suppliers accounted for more than 10% of our purchases and purchases from these suppliers were 13.6% and 12.9%, respectively.

### (g) MAJOR CUSTOMERS

During fiscal 2006, two customers accounted for more than 10% of the Company's sales. Sales to those customers were 30.3% and 11.6% for the three months ended September 30, 2006, and 15.6% and 14.3% for the nine months ended September 30, 2006, respectively.

International sales accounted for approximately 25% and 30% of sales in the three and nine months ended September 30, 2006, respectively. Geographically, Japan has become one of our major growth areas. During the three months and nine months ended September 30, 2006, Japan accounted for 16% and 17%, respectively, of our total sales.

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### (h) STOCK-BASED COMPENSATION

Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123"), established a fair value method of accounting for stock-based compensation plans and for transactions in which an entity acquires goods or services from non-employees in exchange for equity instruments. SFAS No. 123 was amended by Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation -Transition and Disclosure", which required companies to disclose in interim financial statements the pro forma effect on net income (loss) and net income (loss) per common share of the estimated fair market value of stock options or warrants issued to employees. Through December 31, 2005, the Company accounted for stock-based compensation utilizing the intrinsic value method prescribed in Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB No. 25"), with pro forma disclosures of net income (loss) as if the fair value method had been applied. Accordingly, compensation cost for stock options was measured as the excess, if any, of the fair market price of the Company's stock at the date of grant over the amount an employee must pay to acquire the stock.

As the exercise price of stock options and warrants issued to employees was not less than the fair market value of the Company's common stock on the date of grant, and in accordance with accounting for such options utilizing the intrinsic value method, there was no related compensation expense recorded in the Company's 2005 consolidated financial statements. The fair value of stock options and warrants issued to officers, directors and employees at not less than fair market value of the Company's common stock on the date of grant was estimated using the Black-Scholes option-pricing model, and the

10

effect on the Company's results of operations was shown in a proforma disclosure as if such stock options and warrants had been accounted for pursuant to SFAS No. 123.

In December 2004, the Financial Accounting Standards Board ("FASB") issued SFAS No. 123 (revised 2004), "Share Based Payment" ("SFAS No. 123R"), a revision to SFAS No. 123, "Accounting for Stock-Based Compensation". SFAS No. 123R superseded APB No. 25 and amended SFAS No. 95, "Statement of Cash Flows". Effective January 1, 2006, SFAS No. 123R requires that the Company measure the cost of employee services received in exchange for equity awards based on the grant date fair value of the awards, with the cost to be recognized as compensation expense in the Company's financial statements over the vesting period of the awards.

Accordingly, the Company recognizes compensation cost for equity-based compensation for all new or modified grants issued after December 31, 2005. In addition, commencing January 1, 2006, the Company recognizes the unvested portion of the grant date fair value of awards issued prior to adoption of SFAS No. 123R based on the fair values previously calculated for disclosure purposes over the remaining vesting period of the outstanding stock options and warrants.

The Company adopted SFAS No. 123R effective January 1, 2006, and is using the modified prospective method in which compensation cost is recognized beginning with the effective date (a) based on the requirements of SFAS No. 123R for all share-based payments granted after the effective date and (b) based on the requirements of SFAS No. 123R for all awards granted to employees prior to the effective date of SFAS No. 123R that remain unvested on the effective date.

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The total stock based compensation expense for the three and nine months ended September 30, 2006 was \$127,330 and \$356,528, respectively. As of September 30, 2006, the unamortized value of these option awards was \$1,016,300 which will be amortized as compensation cost in future periods as the options vest. 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 periods indicated:

|                                | Nine Months<br>Ended<br>September 30, 2006<br>----- |
|--------------------------------|---|
| Dividend yield .....           | --  |
| Risk-free interest rate .....  | 4.50%   |
| Expected volatility .....      | 46.01%  |
| Expected life of options ..... | 5 years   |

During the three and nine months ended September 30, 2005, the Company did not grant any options to purchase shares of its common stock, nor were there any options vesting during that period. Accordingly, no proforma information for September 30, 2005 is required.

11

(i) 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 is 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.

At September 30, 2006 and 2005, potentially dilutive securities consisted of outstanding common stock options to acquire 682,000 and 0 shares, respectively. These potentially dilutive securities were not included in the calculation of loss per share for the quarter ended September 30, 2006 as these dilutive securities were antidilutive for the nine months ended September 30, 2006 and 2005, as they are insignificant. Accordingly, basic earnings per share for each of the three and nine months ended September 30, 2006, and 2005, are the same as diluted loss per share.

(j) RECLASSIFICATIONS

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

RECENT ACCOUNTING PRONOUNCEMENTS AND DEVELOPMENTS

FASB Statement of Financial Accounting Standards (SFAS) No. 157, "Fair Value Measurements," establishes a formal framework for measuring fair value under

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GAAP. It defines and codifies the many definitions of fair value included among various other authoritative literature, clarifies and, in some instances, expands on the guidance for implementing fair value measurements, and increases the level of disclosure required for fair value measurements. Although SFAS no. 157 applies to and amends the provisions of existing FASB and AICPA pronouncements, it does not, of itself, require any new fair value measurements, nor does it establish valuation standards. SFAS No. 157 applies to all other accounting pronouncements requiring or permitting fair value measurements, except for; SFAS no. 123 (R), share-based payment and related pronouncements, the practicability exceptions to fair value determinations allowed by various other authoritative pronouncements, and AICPA Statements of Position 97-2 and 98-9 that deal with software revenue recognition. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years.

12

### 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 Denim, LLC and Taverniti So Jeans, LLC, 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 after July 24, 2006 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 (increased from \$1.5 million effective as of January 1, 2006) and 50% of the value of eligible raw materials and finished goods. The increase in this line of credit - from \$1.5 million to \$2.4 million - became effective as of January 1, 2006. As of September 30, 2006, the Company drew down \$2.4 million of this credit line against inventory.

As of September 30, 2006, the factor holds \$3,982,414 of accounts receivable purchased from us on a without recourse basis and has made advances to us of \$2,448,295 against those receivables, resulting in a net balance amount Due from Factor of \$1,483,464 net of reserves of \$50,655 as of September 30, 2006. 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 September 30, 2006, the factor also held \$7,971,026 of accounts receivable that were subject to recourse, against which the Company has provided reserves of \$451,807 and as of September 30, 2006, the Company received advances totaling \$9,495,943 against such receivables and against eligible inventory. The Company has included the \$7,519,219 in accounts receivable, and has reflected the \$9,495,943 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.

Before January 1, 2006, the factor commission on receivables purchased on a without recourse basis was 0.8% of the customer invoice amount for terms up to 90 days, plus one quarter of one percent (0.25%) for each additional thirty-day term. Effective January 1, 2006, the factor commission is 0.75% if the aggregate amount of approved invoices is below \$10 million per annum, 0.70%

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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, Chief Executive Officer, President and majority shareholder, and the living trust of Paul and Elizabeth Guez.

13

### NOTE 4 - INVENTORIES

Inventories at September 30, 2006 and December 31, 2005 are summarized as follows:

|                       | September 30,<br>2006 | December 31,<br>2005 |
|-----------------------|-----------------------|----------------------|
|                       | -----                 | -----                |
| Raw Materials .....   | \$ 4,061,236          | \$ 3,850,916         |
| Work-in-Process ..... | 2,990,167             | 2,842,531            |
| Finished Goods .....  | 6,503,050             | 3,231,715            |
|                       | -----                 | -----                |
| TOTAL .....           | \$13,554,453          | \$ 9,925,162         |
|                       | =====                 | =====                |

### NOTE 5 - PROPERTY AND EQUIPMENT

Property and equipment at September 30, 2006 and December 31, 2005 are summarized as follows:

|  | September 30,<br>2006 | December 31,<br>2005 |
|--|-----------------------|----------------------|
|  | -----                 | -----                |
| Furniture .....                                    | \$ 12,973             | \$ 11,217            |
| Leasehold Improvements .....                       | 831,279               | 44,600               |
| Computer Equipment .....                           | 590,287               | 162,659              |
|  | -----                 | -----                |
|  | 1,434,539             | 218,476              |
| Less: Accumulated depreciation and Amortization .. | (156,193)             | (19,549)             |
|  | -----                 | -----                |
|  | \$ 1,278,346          | \$ 198,927           |
|  | =====                 | =====                |

Depreciation expenses for the three months ended September 30, 2006 and 2005 were \$59,174 and \$3,680, respectively and for the nine months ended September 30, 2006 and 2005 were \$136,644 and \$8,489, 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 and Chief Executive Officer. Purchases during the three and nine months ended September 30, 2006 amounted to \$10,555 and \$262,213, respectively. During the same periods last year, they amounted to \$247,470 and \$1,526,223, respectively.

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Azteca Production International Inc. is one of our contractors in Mexico and is co-owned by Paul Guez, our majority stockholder. During the three and nine months ended September 30, 2006, we were invoiced for sewing and other sub-contracting charges in the amounts of \$867,358 and \$2,237,872 respectively,

14

and \$0 and \$391,479 for the three and nine months ended September 30, 2005. Azteca principally provided manufacturing services to Taverniti.

Since January 1, 2006, the Company has leased its facility at Commerce, California from Azteca Production International Inc. as a sub-tenant and is paying it \$19,030 per month.

On July 5, 2005 the Company entered into a ten-year license agreement with Yanuk Jeans, LLC, effective as of July 1, 2005. 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 for the three and nine months ended September 30, 2006 paid or payable to Yanuk Jeans, LLC totaled \$60,902 and \$243,833, respectively, and \$117,987 for the three and nine months ended September 30, 2005, respectively. Yanuk Jeans, LLC is solely owned by Paul Guez, our majority stockholder.

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

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 and nine months ended September 30, 2006 amounted to \$217,728 and \$874,254, respectively, and \$152,000 and \$303,629 for the three and nine months ended September 30, 2005, respectively.

### NOTE 7 - DUE TO/FROM 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 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 September 30, 2006 and December 31, 2005, total trade-related items due to related parties amounted to \$772,261 and \$372,311, 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

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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 on December 31, 2007. As of September 30, 2006 and December 31, 2005, the balance of these advances was \$2,508,900 and \$96,785, respectively, and accrued interest thereon was \$35,372 and \$0, respectively.

15

### 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 \$1,489,453 for the nine months ended September 30, 2006 compared to \$1,376,114 for the same period last year. For the four months ended April 29, 2005 the income earned and related Federal and State income tax obligations for the period of Antik Denim, LLC were passed through to its previous members. For the nine months ended September 30, 2005 the income earned and related Federal and State income tax obligations for the period of Taverniti So Jeans, LLC were passed through to its previous members. The Company recorded no provision for such taxes.

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

|  | 2006         | 2005         |
|--|--------------|--------------|
|  | -----        | -----        |
| Current                                |              |              |
| Federal .....                          | \$ 1,305,011 | \$ 1,234,518 |
| State .....                            | 419,865      | 420,235      |
| Deferred                               |              |              |
| Federal .....                          | (189,462)    | (207,845)    |
| State .....                            | (45,961)     | (70,794)     |
|  | -----        | -----        |
| Provision for income tax expense ..... | \$ 1,489,453 | \$ 1,376,114 |
|  | =====        | =====        |

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

|   | 2006  | 2005   |
|---|-------|--------|
|   | ----- | -----  |
| Statutory federal rate .....                | 34.0% | 34.0%  |
| State taxes, net of federal benefit .....   | 7.1   | 4.8    |
| Income not taxed at the Company level ..... | 2.0   | (11.7) |
| Permanent differences .....                 | (0.1) | 1.8    |
| Other .....                                 | 0.0   | (0.5)  |
|   | ----- | -----  |
| Effective tax rate .....                    | 43.0% | 28.4%  |
|   | ===== | =====  |

In connection with the 2005 Taverniti transaction, in exchange for 100% ownership of Taverniti, the Company issued 500,000 shares of Common Stock of the Company and paid \$750,000 in cash to the previous owners of Taverniti. For

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income tax purposes this transaction was a taxable event. For accounting purposes this transaction was accounted for as combination of entities under common control.

16

Goodwill in the amount of \$4,181,399 was recognized solely for income tax purposes. The tax effect of this goodwill of \$1,687,682 was reported as a deferred tax asset. Additional paid in capital of the Company was increased by an equal amount. During the nine months ended September 30, 2006 the previous owners of Taverniti finalized the filing of their 2005 tax returns which included certain differences than previously estimated. The ultimate effect was previously recognized goodwill was reduced by \$583,000, and the resulting tax effect of the change to the deferred tax benefit of \$233,345 was reflected as adjustment to additional paid in capital of the Company during the nine months ending September 30, 2006.

### 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. Options to purchase 270,000 shares of common stock were granted in 2006. No options to purchase shares of common stock were exercised and 15,000 options were cancelled in 2006.

At September 30, 2006, options outstanding are as follows:

|                               | Number of<br>options | Weighted<br>average<br>exercise<br>price |
|-------------------------------|----------------------|--|
|                               | -----                | -----                                    |
| Balance at January 1, 2006 .. | 427,000              | \$ 7.18                                  |
| Granted .....                 | 270,000              | \$ 5.20                                  |
| Exercised .....               | --                   | --                                       |
| Cancelled .....               | (15,000)             | \$ 5.20                                  |
|                               | -----                | -----                                    |
| Balance at September 30, 2006 | 682,000              | \$ 6.44                                  |
|                               | =====                | =====                                    |

Additional information regarding options outstanding as of September 30, 2006 is as follows:

| OPTIONS OUTSTANDING |                       |   |  | OPTIONS EXERCISABLE   |  |                                 |  |
|---------------------|-----------------------|---|--|-----------------------|--|---------------------------------|--|
| Exercise<br>Price   | Number<br>Outstanding | Weighted<br>Average<br>Remaining<br>Contractual<br>Life | Weighted<br>Average<br>Exercise<br>Price | Number<br>Exercisable | Weighted<br>Average<br>Exercise<br>Price | Aggregate<br>Intrinsic<br>Value |  |
| -----               | -----                 | -----   | -----                                    | -----                 | -----                                    | -----                           |  |
| \$8.10              | 62,000                | 8.68  | \$ 8.10                                  | 22,000                | \$ 8.10                                  | \$ 73,480                       |  |
| \$7.40              | 300,000               | 8.86  | \$ 7.40                                  | 100,000               | \$ 7.40                                  | \$ 305,000                      |  |
| \$5.30              | 65,000                | 8.87  | \$ 5.30                                  | 25,000                | \$ 5.30                                  | \$ 54,750                       |  |
| \$5.20              | 255,000               | 9.25  | \$ 5.20                                  | --                    |  |                                 |  |



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|                 |         |      |         |         |         |            |
|-----------------|---------|------|---------|---------|---------|------------|
| \$5.20 - \$8.10 | 682,000 | 8.99 | \$ 6.44 | 147,000 | \$ 7.15 | \$ 433,230 |
|-----------------|---------|------|---------|---------|---------|------------|

NOTE 10 - TERMINATION OF MATERIAL DEFINITIVE AGREEMENTS

On October 5, 2006, we terminated the Letter of Intent previously entered into with Global Fashion Group, SA ("Global Fashion Group") on March 31, 2006, which would have formed a new joint venture company with a license to produce, manufacture and distribute apparel and accessories for the Registrant's three principal brands, Antik Denim, Taverniti So Jeans and Yanuk, throughout Europe and other territories. The parties were unable to resolve certain differences in the terms of the license to be held by the joint venture company contemplated under the Letter of Intent.

On October 9, 2006 we reached a mutual agreement with Long Rap, Inc. to terminate our proposed agreement to acquire the company and its retail operations, which was previously announced on June 20, 2006. Both companies have determined that it would be in the best interests of their respective shareholders not to proceed with the acquisition at this time. The accompanying statement of operations for the nine months ended September 30, 2006 includes \$500,887 of costs relating to the abandonment of this acquisition.

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

FORWARD-LOOKING STATEMENTS

Statements made in this Form 10-QSB (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"). The Company intends that such forward-looking statements be subject to the safe harbors for such statements. The Company wishes 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 the control of the Company. Although the Company believes 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 Form 10-QSB 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 the Company or any other person that the objectives and plans of the Company will be achieved. The Company disclaims any obligation to subsequently revise any forward-looking

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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," "are expected to," "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 Form 10-QSB or included in our previous filings with the Securities and Exchange Commission ("SEC").

### DESCRIPTION OF BUSINESS

#### OVERVIEW

We design, manufacture and market high-end fashion jeans, apparel and accessories under the principal brand names ANTIK DENIM, TAVERNITI SO JEANS and YANUK. Our products include jeans, jackets, belts, purses and T-shirts. We sell premium denim products and accessories in high-end department stores and fashion boutiques that cater to fashion conscious consumers. Our products are currently sold in the United States, Canada, Japan and the European Union directly to department stores and boutiques, including Bloomingdales, Nordstrom, Macy's, Saks and Fred Segal, and through distribution arrangements in a number of countries abroad.

We operate in the high-end fashion denim industry. Our current competitors are companies that market such brands as Joe's Jeans, True Religion, Seven For All Mankind and Citizens of Humanity.

19

Our goal is to build a broad and diversified portfolio of brands selling premium denim products and accessories across a range of retail price points through wholesale and retail distribution channels.

#### 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"), one of our existing shareholders, 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

On September 15, 2006, we entered into a Joint Venture Agreement Term

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Sheet with Philippe Naouri and Alexandre Caugant, the members of Life & Death, LLC ("L&D"), pursuant to which we acquired 50% of the membership interests of L&D. L&D owns the LIFE & DEATH trademark application and designs, develops, manufactures and distributes knit apparel under the brand LIFE & DEATH. We share 50% in the profits and losses of L&D based on our membership interest in L&D. Alexandre Caugant and Philippe Naouri are the principal designers of LIFE AND DEATH.

On October 5, 2006, we agreed to terminate the Letter of Intent previously entered into with Global Fashion Group, SA ("Global Fashion Group") on March 31, 2006, which would have formed a new joint venture company with a license to produce, manufacture and distribute apparel and accessories for our three principal brands, ANTIK DENIM, TAVERNITI SO JEANS and YANUK, throughout Europe and other territories. The initial term of the license would have been for two years, with automatic renewal for an additional three-year term if the joint venture achieved target net sales and was not in breach of the license. We were unable to come to an agreement with Global Fashion Group on the final terms of the license to be held by the joint venture company contemplated under the Letter of Intent.

On October 10, 2006, we mutually agreed with Long Rap, Inc. to terminate the Agreement and Plan of Merger ("Merger Agreement") previously entered into on June 19, 2006 among LR Acquisition Corporation, a District of Columbia corporation and our wholly-owned subsidiary ("LR Acquisition"), Long Rap, the stockholders of Long Rap and Charles Rendelman, as the Long Rap stockholders' representative, pursuant to which Long Rap would have merged with and into LR Acquisition with LR Acquisition surviving the merger. We determined, along with Long Rap, that it would be in the best interests of our respective stockholders not to proceed with the merger at this time. We incurred \$500,887 relating to the abandonment of this acquisition.

In accordance with the provisions of the Merger Agreement, we paid Long Rap \$50,000 and have undertaken to pay 50% of the invoices (fees and expenses) delivered by Long Rap's independent registered public accounting firm in connection with the audit of Long Rap's financial statements, which amounted to about \$ 150,000. It has been agreed that we will pay the final invoice for audit services directly to the independent registered public accounting firm and remit to Long Rap the difference between the amount of such final invoice and 50% of the total audit fees and expenses.

20

### OUR PRODUCTS AND BRANDS

We offer multiple brands of apparel in the premium and better denim segments. As a result of a license agreement with Yanuk Jeans, LLC and the acquisition of Taverniti So Jeans, LLC, our wholly-owned subsidiary ("Taverniti"), we currently market our products under the ANTIK DENIM, TAVERNITI SO JEANS and YANUK brands. Our products are sold in the United States and abroad to upscale retailers and boutiques. We currently sell men's and women's styles and have launched a children's line for both ANTIK DENIM and TAVERNITI SO JEANS. In addition, Antik Denim, LLC, our wholly-owned subsidiary ("Antik Denim"), is a party to a license agreement with Titan Industries, Inc. that provides Titan with an exclusive right to use the ANTIK DENIM brand for the sale of men's and women's footwear in the United States, Canada and Mexico, and a right of first refusal for similar use of the brand in Europe and South America. The footwear line was launched in July 2006.

Our products are made from high quality fabrics milled in the United

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States, Japan, Italy and Spain and are processed with cutting-edge treatments and finishes. Our concepts and designs, including ANTIK DENIM's distinct vintage western flair, and our extraordinary fit, embellishments, patent pending pockets, unique finishes, hand stitching, embroidery detail and other attention to detail and quality give our products a competitive advantage in the high-end fashion denim and accessories market.

Our jeans are available in multiple combinations of washes, fabrics and finishes, with as many as 20 different combinations of colors, fabrics and finishes on certain styles. We typically introduce new versions of our major styles each month in different colors, washes and finishes. Although our denim products have accounted for the substantial majority of our total sales, our product lines include knits, woven tops and accessories, the sales of which we anticipate will continue to increase.

### DESIGN AND DEVELOPMENT

Each of our brands has an independent design team striving to develop a distinct look and feel to the products based on an overall design philosophy. Product mix between denim and non-denim products and retail price points vary by brand.

ANTI-K DENIM. The designers of ANTI-K DENIM are Philippe Naouri and Alexandre Caugant, both of whom have significant experience in the denim industry, in both selling and designing vintage inspired offerings. Their principal design philosophy is based on vintage western styling featuring a very unique and distinctive back pocket.

TAVERNITI SO JEANS. The designer of the TAVERNITI SO JEANS line is Jimmy Taverniti, well known as an Italian couture designer with significant experience as a denim designer. The principal design philosophy is sportswear driven looks with vintage and rock and roll styling.

YANUK. The designer of the YANUK line is Benjamin Taverniti, the son of Jimmy Taverniti. The principal design philosophy is focused less on embroidery and more on subtle design details and fit.

Mr. Guez participates in design efforts and provides significant input with respect to the development of new lines and brands. We do not have in place any formal design and development plan at this time. However, since our inception in 2004, we have allocated significant resources to our design and development activities. In the three and nine months ended September 30, 2006, our design and development expenses were approximately \$0.37 million and \$1.27 million, respectively.

### MANUFACTURING AND SOURCING

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 September 30, 2006, three suppliers accounted for more than 10% of our purchases. Purchases from these suppliers were 31.5%, 13.0% and 11.8%, respectively. During the nine months ended September 30, 2006, two suppliers accounted for more than 10% of our purchases, and purchases from these suppliers were 13.6% and 12.9%, respectively. We have the ability to replace our suppliers

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of raw materials as needed without significantly affecting our business or operations.

We presently outsource all of our manufacturing needs to contract vendors using just in time ordering. We use several contract vendors for our manufacturing needs with the bulk of purchases (approximately 70%) currently made from domestic manufacturers. We are increasing the use of contract manufacturers in Mexico and the Far East. We do not rely on any one manufacturer and we believe additional manufacturing capacity is available to meet our current and planned needs. We maintain rigorous quality control systems for both raw and finished goods. We will continue to outsource the majority of our production capacity to maintain low fixed expenses. We will add contract manufacturers as required to meet our needs. During the three months ended September 30, 2006, two sub-contractors accounted for 17.9% and 13.6% of our manufacturing, and two contractors accounted for 19.2% and 14.2% of our manufacturing during the nine months ended September 30, 2006. One of these sub-contractors, which principally provided manufacturing services to Taverniti, is Azteca Production International Inc., a company co-owned by Paul Guez, our Chairman, Chief Executive Officer and President.

We believe we can realize significant cost savings in product manufacturing because of our strong relationships with a diverse group of U.S. and international contract manufacturers established by our management team through their prior experience in the apparel industry. In addition, the increase in production volume as a result of our multi-brand strategy will give us economies of scale to achieve further cost savings.

### MARKETING, DISTRIBUTION AND SALES

We market, distribute and sell our products in the United States and internationally in a number of other countries such as Canada, Belgium, France, Germany, Sweden, Italy, Korea and Japan.

Our products are sold in the United States in department stores and boutiques such as Saks, Neiman Marcus, Nordstrom, Bloomingdales, Atrium, Fred Segal, Intermix, Kitson and Henri Bendel, as well as smaller boutiques throughout the country. Our products are sold internationally to department stores and boutiques such as Lane Crawford in Hong Kong, Harrods and Harvey Nichols in the United Kingdom, Barneys New York and Isetan in Japan, Galleries Lafayette in France, and Holt Renfrew in Canada.

We market and distribute our products by participating in industry trade shows, as well as through our show rooms in Los Angeles and New York. We maintain distributor relationships in the United Kingdom, France, Germany, Sweden, Greece, Belgium, Italy, Mexico and Japan. Except for Mexico, Japan and Canada, we currently have no exclusive or long term distribution agreements with any party covering any territory, and do not depend on any single distributor to distribute our products. Our distributors often, but not always, purchase products from us at a discount for resale to their

22

customers in their respective territories. Our distributors warehouse our products at their expense and they ship to and collect payment from their customers directly.

### TRADEMARKS AND OTHER INTELLECTUAL PROPERTY

Antik Denim is the holder of trademark applications for the ANTIQUE

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DENIM and ANTIK DENIM marks in the United States and various other foreign jurisdictions. Antik Denim also owns several proprietary concepts and designs, including pending trademark and patent applications on its pocket designs. Yanuk Jeans, LLC, from whom we hold exclusive licenses to exploit products based on the YANUK and U brands, is the holder of several United States and foreign trademarks.

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 sportswear categories for men and women. It is paying royalties to Taverniti Holdings LLC in the range of five to eight 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.

We have made and will continue to make efforts to minimize domestic and international counterfeiting of ANTIK DENIM'S stylized pocket design and infringement of our other intellectual property rights, including through litigation if necessary.

### GOVERNMENT REGULATION AND SUPERVISION

We benefit from certain international treaties and regulations, such as the North American Free Trade Agreement (NAFTA), which allows for the duty and quota free entry into the United States of certain qualifying merchandise. International trade agreements and embargoes by entities such as the World Trade Organization also can affect our business, although their impact has historically been favorable.

We have implemented various programs and procedures, including unannounced inspections, to ensure that all of the apparel manufacturers with whom we contract fully comply with employment and safety laws and regulations governing their place of operation.

### EMPLOYEES

As of November 7, 2006, we had 114 employees, not including our three executive officers, Paul Guez, our Chairman, Chief Executive Officer and President, Patrick Chow, our Chief Financial Officer and Secretary, and Gregory Abbou, President of Taverniti. Mr. Guez leads our product development, marketing and sales, and Mr. Chow oversees all financial aspects of our business. Our employees are not unionized. Except for agreements with Messrs. Naouri and Caugant, who comprise the design team for our ANTIK DENIM brand, no employees, including our executive officers, are subject to existing employment agreements with us.

### FACILITIES

### PRINCIPAL EXECUTIVE OFFICES

Our principal executive offices are located at 5804 East Slauson Avenue, Commerce, California 90040. Our telephone number is (323) 725-5555.

### DESCRIPTION OF PROPERTY

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On April 27, 2006, we entered into a Sublease with Azteca Production International, Inc. to lease approximately 73,193 square feet of office and warehouse space located at 5804 East Slauson Avenue, Commerce, California, the location of our current principal executive offices, warehouse and distribution center. Azteca is co-owned by Mr. Guez, our Chief Executive Officer, President and Chairman. We previously occupied approximately 67,000 square feet of the office and warehouse space covered under the Sublease pursuant to our Service Agreement with Blue Concept, LLC. The Service Agreement with Blue Concept, LLC expired by its terms on December 31, 2005.

Although executed on April 27, 2006, the term of the Sublease became effective as of January 1, 2006, and will continue on a month-to-month basis with termination by either party permitted upon 90-days prior written notice. We pay monthly rent of approximately Nineteen Thousand Thirty Dollars (\$19,030) to Azteca. The Sublease was approved by a majority of our Board of Directors, including all of the independent directors.

We also maintain showrooms in both Los Angeles and New York City. The cost of operations at the Commerce facility and the showrooms was shared by several companies and the portion of the cost that we paid in 2005 was allocated to us under our Service Agreement with Blue Concept, LLC. Since January 1, 2006, we have been paying for the use of these showrooms based on our actual use.

On August 27, 2005, we opened a retail store in Los Angeles, California and assumed all the obligations of a 10-year property lease, which was previously signed by Blue Concept, LLC in April, 2005. We are paying \$21,840 per month for the lease of the shop space. More recently, On July 18, 2006, we entered into lease agreements with Emporium Development, L.L.C. ("Emporium") to lease approximately 3,272 square feet of space located at 865 Market Street, San Francisco, California 94103. Although executed on July 18, 2006, the term of the Sublease became effective as of July 5, 2006, and will continue for a term expiring on January 31, 2017. We will pay annual rent to Emporium ranging from \$261,760 at the commencement of the term to \$326,902 at the end of the term. We will also pay, as percentage rental, six percent (6%) of gross sales made in and from the premises in excess of annual breakpoints ranging from \$4,362,667 at the commencement of the term to \$5,448,373 at the end of the term.

We believe that the facilities utilized by us are well maintained, in good operating condition and adequate to meet our current and foreseeable needs.

### LIQUIDITY AND CAPITAL RESOURCES

For the nine months ended September 30, 2006, net cash used in operating activities was \$(6.2 million). The deficit was primarily due to an increase of \$3.6 million in inventory and \$3.6 million in accounts receivables and was offset by an increase in accounts payable of \$0.6 million and an increase in due to related parties of \$0.4 million. Net cash provided by financing activities was \$7.3 million that included \$4.9 million from short-term borrowings and \$2.4 million advanced from the majority shareholder. We utilized \$1.2 million in investing activities which primarily consist of \$0.8 million for leasehold improvements at our new store in San Francisco and \$0.4 million for purchases of fixed assets.

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 Denim, LLC and Taverniti So Jeans, LLC, 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 after July 24, 2006, 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 (increased from \$1.5 million effective as of January 1, 2006) and 50% of the value of eligible raw materials and finished goods. The increase in this line of credit - from \$1.5 million to \$2.4 million - became effective as of January 1, 2006. As of September 30, 2006, we drew down \$2.4 million of this credit line.

Before January 1, 2006, the factor commission was 0.8% of the customer invoice amount for terms up to 90 days, plus one quarter of one percent (.25%) for each additional thirty-day term. Effective January 1, 2006, 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, Chief Executive Officer, President 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 \$10 million as of September 30, 2006. The factor commission is 0.4% for receivables purchased subject to recourse. Receivables subject to recourse approximated \$8.2 million net of reserves as of September 30, 2006. 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, 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. 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 annual interest rate of 6%. The Company may repay the advances in full or in part at any time until the credit line expires on December 31, 2007. As of September 30, 2006, the balance of these advances was \$2,508,900.

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 may seek to finance future capital needs through various means and channels, such as issuance of long-term debt or sale of equity securities.



## 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 September 30, 2006, the factor holds \$3,982,414 of accounts receivable purchased from us on a without recourse basis and has made advances to us of \$2,448,295 against those receivables, resulting in a net balance due from the factor of \$ 1,483,464, net of reserves of \$50,655, as of September 30, 2006. 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."

## RESULTS OF OPERATIONS

The acquisition of Antik Denim, LLC in 2005 was accounted for as a reverse merger (recapitalization) in the accompanying financial statements with Antik Denim deemed to be the accounting acquirer, and Blue Holdings deemed to be the legal acquirer. The exchange transaction with Taverniti So Jeans, LLC was accounted for as a combination of entities under common control, and its 2005 results were combined with those of Antik Denim and Blue Holdings, respectively. Accordingly, our results of operations before the completion of these transactions, including our operating results before April 29, 2005 (when we completed the acquisition of Antik Denim), reflect the operations of Antik Denim and Taverniti.

## THREE MONTHS ENDED SEPTEMBER 30, 2006 VS. 2005

Net sales increased from \$13.9 million for the three months ended September 30, 2005 to \$14.6 million for the three months ended September 30, 2006. The growth was slower than expected due to the failure of a major European distributor to fulfill its projections and the cancellation of some orders caused by the production delays of a major vendor.

Gross profit was \$4.4 million in the third quarter of 2006 as compared with \$6.9 million for the same period last year. The decrease in gross profit is largely attributable to sales discounts given to retailers on the disposal of inventory produced in anticipation of projected European orders that did not materialize and merchandise that were late from production.

Selling, distribution and administrative expenses for the three months ended September 30, 2006 totaled \$4.3 million or 29% of net sales compared with \$3.3 million or 23.5% of net sales for the same period last year. The increase was caused by the expansion of overhead at the beginning of the year in anticipation of higher revenue and higher sales projections and resources and expenses committed to the terminated transaction with the proprietor of a chain of retail stores. The principal components during the three months ended September 30, 2006 were payroll of \$2.28 million (compared to \$0.63 million for the same period last year), trade shows expenses \$0.27 million (compared to \$0.06 million for the same period last year), royalties of \$0.51 million (\$0.27 million in same period of 2005), stock-based compensation of \$0.13 million (none in 2005) and non-recurring expenses of \$0.06 million on opening of the San Francisco store (none in 2005).

Net Income (Loss) after provision for taxes in the third quarter of 2006 was (\$0.4 million) or 2.9% of net sales compared to \$2.4 million or 17% of

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net sales in the third quarter of 2005. Basic and diluted earnings (loss) per share were (\$0.02) in the third quarter of 2006 compared to \$0.09 in the same period of last year. For the three months ended September 30, 2006, the Company provided (\$0.18

26

million) for income tax compared to \$1.24 million in the same period last year. During the three months ended September 30, 2005, the income (loss) and related Federal and State income tax obligations were passed through to the previous members of Taverniti So Jeans, LLC.

### NINE MONTHS ENDED SEPTEMBER 30, 2006 VS. 2005

Net sales increased from \$24.6 million for the nine months ended September 30, 2005 to \$41.6 million for the nine months ended September 30, 2006. The growth was slower than expected due to the failure of a major European distributor to fulfill its projections and the cancellation of some orders in the third quarter of 2006 caused by the production delays of a major vendor.

Gross profit for the nine months ended September 30, 2006 increased to \$17.8 million, or 42.8% of net sales from \$12.2 million or 49.7 % of net sales for the same period last year. The decline in gross profit percentage to net sales is due to sales discounts given to retailers on disposal of merchandise produced in anticipation of European orders that did not materialize and merchandise late from production in the third quarter of 2006.

Selling, distribution and administrative expenses for first nine months of 2006 totaled \$13.2 million compared with \$6.4 million for the same period last year. The increase was caused by the expansion of overhead at the beginning of the year in anticipation of higher revenue and higher sales projections for the year [and resources and expenses committed to the terminated transaction with the proprietor of a chain of retail stores]. The principal components during the first nine months of 2006 were payroll of \$5.8 million (compared to \$1.2 million during the same period last year), advertising and trade show expenses of \$1.03 million (\$0.46 million in the same period of 2005), travel expenses of \$0.48 million (\$0.19 million in the same period of 2005), royalties of \$1.3 million (\$0.42 million in 2005) and stock-based compensation of \$0.36 million (none in 2005).

Net Income after provision for taxes for nine months ended September 30, 2006 was \$1.9 million or 4.7% of net sales compared to \$3.9 million or 15.8% of net sales during the same period last year. Basic and diluted earnings per share were \$0.08 for the nine months of 2006 compared to \$0.15 in the same period of last year. For the nine months ended September 30, 2006, the Company provided \$1.5 million for income tax compared to \$1.4 million in the same period last year. During the nine months ended September 30, 2005, the income (loss) and related Federal and State income tax obligations for the period were passed through to the previous members of Taverniti So Jeans, LLC. These tax obligations for Antik Denim, LLC between January 1 and April 29, 2005 were also passed through to its previous members. The Company only recorded provisions for income taxes on the income of Antik Denim, LLC between April 30 and September 30, 2005 during nine months ended September 30, 2005.

### CRITICAL ACCOUNTING POLICIES

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

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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.

27

### 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

Trade accounts receivable are recorded at invoiced amounts, less amounts accrued for returns, discounts and allowances. An allowance is provided for specific customer accounts where collection is doubtful and for inherent risk in our ability to ultimately collect those receivables. There is no off-balance sheet credit exposure related to customer receivables.

### 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.

### RECENT ACCOUNTING PRONOUNCEMENTS AND DEVELOPMENTS

FASB Statement of Financial Accounting Standards (SFAS) No. 157, "Fair Value Measurements," establishes a formal framework for measuring fair value under GAAP. It defines and codifies the many definitions of fair value included among various other authoritative literature, clarifies and, in some instances, expands on the guidance for implementing fair value measurements, and increases the level of disclosure required for fair value measurements. Although SFAS no. 157 applies to and amends the provisions of existing FASB and AICPA pronouncements, it does not, of itself, require any new fair value measurements, nor does it establish valuation standards. SFAS No. 157 applies to all other accounting pronouncements requiring or permitting fair value measurements, except for; SFAS no. 123 (R), share-based payment and related pronouncements,

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the practicability exceptions to fair value determinations allowed by various other authoritative pronouncements, and AICPA Statements of Position 97-2 and 98-9 that deal with software revenue recognition. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years.

SFAS No. 158 requires that for public companies the full funding status of defined benefit pension and other postretirement plans to be recognized on the balance sheet as an asset (for overfunded plans) or as a liability (for underfunded plans). In addition, SFAS No. 158 calls for recognition in other comprehensive income or gains or losses and prior service costs or credits that are not yet included as components of

28

periodic benefit expense. Finally, SFAS No. 158 requires that the measurement of defined benefit plan assets and obligations be as of the balance sheet date. The Company plans to adopt the recognition provisions of SFAS No. 158 as of the end of the fiscal year end after December 15, 2006 and the measurement date provisions as of the balance sheet date for fiscal years ending after December 15, 2008.

### 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 OUR 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.

### RISKS RELATED TO OUR BUSINESS

WE HAVE A LIMITED OPERATING HISTORY, MAKING IT DIFFICULT TO EVALUATE WHETHER WE WILL OPERATE PROFITABLY.

Antik Denim 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. 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

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- 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

29

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 significant growth in 2006. 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.

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

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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 Denim 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:

30

- 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;
- 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

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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 42% of our total receivables at September 30, 2006 and two customers who accounted for 30.3% and 11.6%, respectively, of our sales for the three months ended September 30, 2006. A decrease in business from or loss of a any significant customer could 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.

31

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



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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.

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 three and nine months ended September 30, 2006, 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.

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

33

- 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.

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.

DIFFICULTY IN MANAGING ANTICIPATED GROWTH COULD HAVE A MATERIAL ADVERSE IMPACT ON OUR BUSINESS AND OPERATING RESULTS.

We anticipate growing our business in part through the acquisition of additional companies and/or license of additional brands depending upon a company's and/or a brand's sales revenues, name and brand recognition, and/or synergies with our existing brands. The acquisition and integration of these businesses and or brands will be complex and time and resource-consuming, and

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our management will have to dedicate substantial effort to it. These efforts could divert management's focus and resources from other strategic opportunities and from operational matters during the integration process, which could adversely impact our business and operating results.

### OTHER RISKS RELATED TO US

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

34

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 November 13, 2006, our Chief Executive Officer, Paul Guez, Chief Financial Officer, Patrick Chow and two members of our design team, Messrs. Naouri and Caugant, owned approximately 79.7% of the outstanding shares of our common stock. Paul and Elizabeth Guez, Mr. Guez's wife and our former Chief Operating Officer, alone owned approximately 72% of the outstanding shares of our common stock at November 13, 2006. 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.

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.

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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.

35

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;
- 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. CONTROLS AND PROCEDURES

As of September 30, 2006, the end of the period covered by this Quarterly Report on Form 10-QSB, we conducted an evaluation, under the supervision and with the participation of our Chief Executive Officer and Chief

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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 September 30, 2006, our disclosure controls and procedures were effective.

During the quarter ended September 30, 2006, 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.

36

PART II

ITEM 6. EXHIBITS

See Exhibit Index.

37

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: November 14, 2006

By: /s/ Patrick Chow

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Patrick Chow  
Chief Financial Officer and Secretary

38

EXHIBIT INDEX

| Exhibit<br>Number | Description of Exhibit   |
|-------------------|--|
| 10.1              | Amendment No. 1 to License Agreement dated October 5, 2005, dated July 14, 2006, between the Company and Yanuk Jeans, LLC.                           |
| 10.2              | Lease dated July 18, 2006, between the Company and Emporium Development, L.L.C.  |
| 10.3              | Lease Addendum dated July 18, 2006, between the Company and Emporium Development, L.L.C.   |
| 10.4              | Assignment, Assumption and Amendment Agreement dated July 31, 2006, among Taverniti So Jeans, LLC, Caitac International, Inc. and Blue Concept, LLC. |

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- 10.5 Inventory Loan Facility Agreement dated July 25, 2005, between the Company and FTC Commercial Corp.
- 10.6 Inventory Loan Facility Agreement dated July 25, 2005, between Antik Denim, LLC and FTC Commercial Corp.
- 10.7 Inventory Loan Facility Agreement dated October 31, 2005, between Taverniti So Jeans, LLC and FTC Commercial Corp.
- 10.8 Amendment No. 1 to Inventory Loan Facility Agreement dated July 25, 2005, dated August 4, 2006 and Effective as of July 26, 2005, between the Company and FTC Commercial Corp.
- 10.9 Amendment No. 2 to Inventory Loan Facility Agreement dated July 25, 2005, dated August 4, 2006 and Effective as of October 31, 2005, between the Company and FTC Commercial Corp.
- 10.10 Amendment No. 3 to Inventory Loan Facility Agreement dated July 25, 2005, dated August 4, 2006 and Effective as of January 1, 2006, between the Company and FTC Commercial Corp.
- 10.11 Amendment No. 1 to Inventory Loan Facility Agreement dated July 25, 2005, dated August 4, 2006 and Effective as of July 26, 2005, between Antik Denim, LLC and FTC Commercial Corp.
- 10.12 Amendment No. 2 to Inventory Loan Facility Agreement dated July 25, 2005, dated August 4, 2006 and Effective as of October 31, 2005, between Antik Denim, LLC and FTC Commercial Corp.
- 10.13 Amendment No. 3 to Inventory Loan Facility Agreement dated July 25, 2005, dated August 4, 2006 and Effective as of January 1, 2006, between Antik Denim, LLC and FTC Commercial Corp.
- 10.14 Amendment No. 1 to Inventory Loan Facility Agreement dated October 31, 2005, dated August 4, 2006 and Effective as of January 1, 2006, between Taverniti So Jeans, LLC and FTC Commercial Corp.
- 10.15 Guaranty dated October 31, 2005, between Taverniti So Jeans, LLC and FTC Commercial Corp.
- 10.16 Guaranty dated October 31, 2005, between Taverniti So Jeans, LLC and FTC Commercial Corp.
- 10.17 Guaranty dated July 25, 2005 between Antik Denim, LLC and FTC Commercial Corp.
- 10.18 Indemnity Agreement for Factor and Supplier Guarantees, dated August 4, 2006 and Effective January 1, 2006, among the Company and FTC Commercial Corp.
- 10.19 Indemnity Agreement for Factor and Supplier Guarantees, dated August 4, 2006 and Effective January 1, 2006, among Antik Denim, LLC and FTC Commercial Corp.
- 10.20 Indemnity Agreement for Factor and Supplier Guarantees, dated August 4, 2006 and Effective January 1, 2006, among Taverniti So Jeans, LLC and FTC Commercial Corp.

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- 10.21 Continuing Security Agreement dated June 25, 2005, between the Company and FTC Commercial Corp.
- 10.22 Continuing Security Agreement dated June 25, 2005, between Antik Denim, LLC and FTC Commercial Corp.
- 10.23 Continuing Security Agreement dated October 31, 2005, between Taverniti So Jeans, LLC and FTC Commercial Corp.
- 10.24 Amendment to Continuing Security Agreement dated June 25, 2005, dated August 4, 2006 and Effective October 31, 2005, between the Company and FTC Commercial Corp.
- 10.25 Amendment to Continuing Security Agreement dated June 25, 2005, dated August 4, 2006 and Effective October 31, 2005, between Antik Denim, LLC and FTC Commercial Corp.
- 10.26 Revolving Promissory Note dated August 7, 2006, between the Company and Paul Guez.
- 10.27.1 Joint Venture Agreement Term Sheet dated September 15, 2006, among the Company, Philippe Naouri and Alexandre Caugant.
- 10.27.2 Membership Acquisition Agreement dated September 20, 2006, between the Company and Life & Death, LLC.
- 10.27.3 Operating Agreement of Life & Death, LLC.
- 10.28 Assignment and Assumption of Lease effective as of August 1, 2005, among the Company, Blue Concept, LLC and Melrose Edinburgh, LLC.
- 10.29 Letter terminating Letter of Intent with Global Fashion Group, SA.
- 10.30 Letter terminating Agreement and Plan of Merger with Long Rap, Inc.
- 31.1 Certification of Principal Executive Officer pursuant to Securities Exchange Act Rules 13a-14(a) or 15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Principal Financial Officer pursuant to Securities Exchange Act Rules 13a-14(a) or 15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 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.
- 32.2 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.