

JOE'S JEANS INC.  
Form 10-Q  
July 15, 2008

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

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

For the quarterly period ended May 31, 2008

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 0-18926

**JOE S JEANS INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation or  
organization)

**11-2928178**

(I.R.S. Employer Identification No.)

**5901 South Eastern Avenue, Commerce, California**

(Address of principal executive offices)

**90040**

(Zip Code)

**(323) 837-3700**

(Registrant's telephone number, including area code)

**NO CHANGE**

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject

Edgar Filing: JOE'S JEANS INC. - Form 10-Q

to such filing requirements for the past 90 days.

Yes       No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

|  |   |
|--|---|
| Large accelerated filer <input type="radio"/>          | Accelerated filer <input type="radio"/>         |
| Non-accelerated filer <input checked="" type="radio"/> | Smaller reporting company <input type="radio"/> |
| (Do not check if a smaller reporting company)          |   |

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

The number of shares of the registrant's common stock outstanding as of July 14, 2008 was 59,808,767.

---

JOE S JEANS INC.

QUARTERLY REPORT ON FORM 10-Q

|   | <b>Page</b> |
|---|-------------|
| <b><u>PART I.</u></b>   |             |
| <b><u>FINANCIAL INFORMATION</u></b>   |             |
| <u>Item 1.</u>  | 1           |
| <u>Financial Statements.</u>  |             |
| <u>Item 2.</u>  | 18          |
| <u>Management's Discussion and Analysis of Financial Condition and Results of Operations.</u> |             |
| <u>Item 3.</u>  | 29          |
| <u>Quantitative and Qualitative Disclosures about Market Risk.</u>                            |             |
| <u>Item 4.</u>  | 30          |
| <u>Controls and Procedures.</u>   |             |
| <u>Item 4T.</u>   | 31          |
| <u>Controls and Procedures.</u>   |             |
| <b><u>PART II.</u></b>  |             |
| <b><u>OTHER INFORMATION</u></b>   |             |
| <u>Item 1.</u>  | 31          |
| <u>Legal Proceedings.</u>   |             |
| <u>Item 1A.</u>   | 31          |
| <u>Risk Factors.</u>  |             |
| <u>Item 2.</u>  | 31          |
| <u>Unregistered Sales of Equity Securities and Use of Proceeds.</u>                           |             |
| <u>Item 3.</u>  | 31          |
| <u>Defaults Upon Senior Securities.</u>   |             |
| <u>Item 4.</u>  | 31          |
| <u>Submission of Matters to a Vote of Security Holders.</u>                                   |             |
| <u>Item 5.</u>  | 31          |
| <u>Other Information.</u>   |             |
| <u>Item 6.</u>  | 32          |
| <u>Exhibits.</u>  |             |
| <b><u>SIGNATURES</u></b>  | 33          |

---

## PART I FINANCIAL INFORMATION

## Item 1. Financial Statements.

## JOE S JEANS INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands)

|   | May 31, 2008<br>(unaudited) | November 30, 2007 |
|---|-----------------------------|-------------------|
| <b>ASSETS</b>   |                             |                   |
| Current assets  |                             |                   |
| Cash and cash equivalents   | \$ 2,551                    | \$ 1,331          |
| Accounts receivable, net of allowance for customer credits and returns of \$597 (2008) and \$652 (2007) | 1,244                       | 803               |
| Inventories, net  | 18,693                      | 20,803            |
| Prepaid expenses and other current assets   | 404                         | 282               |
| Total current assets  | 22,892                      | 23,219            |
| Property and equipment, net   | 737                         | 792               |
| Goodwill  | 11,116                      | 10,415            |
| Intangible assets, net  | 13,200                      | 13,200            |
| Other assets  | 70                          |                   |
| Total assets  | \$ 48,015                   | \$ 47,626         |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>  |                             |                   |
| Current liabilities   |                             |                   |
| Accounts payable and accrued expenses   | \$ 6,415                    | \$ 7,794          |
| Due to factor   | 2,649                       | 3,040             |
| Due to related parties  | 9                           | 1,142             |
| Total current liabilities   | 9,073                       | 11,976            |
| Deferred tax liability  | 5,254                       | 5,254             |
| Commitments and contingencies   |                             |                   |
| Stockholders' equity  |                             |                   |
| Preferred stock, \$0.10 par value: 5,000 shares authorized, no shares issued or outstanding             |                             |                   |
| Common stock, \$0.10 par value: 100,000 shares authorized, 59,862 shares issued and 59,750 outstanding  | 5,988                       | 5,988             |
| Additional paid-in capital  | 102,490                     | 102,056           |
| Accumulated deficit   | (72,014)                    | (74,872)          |
| Treasury stock, 112 shares  | (2,776)                     | (2,776)           |
| Total stockholders' equity  | 33,688                      | 30,396            |
| Total liabilities and stockholders' equity  | \$ 48,015                   | \$ 47,626         |

The accompanying notes are an integral part of these financial statements.



## JOE S JEANS INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

|  | Three months ended |              | Six months ended |              |
|--|--------------------|--------------|------------------|--------------|
|  | May 31, 2008       | May 26, 2007 | May 31, 2008     | May 26, 2007 |
|  | (unaudited)        |              | (unaudited)      |              |
| Net sales                                  | \$ 17,955          | \$ 15,171    | \$ 33,165        | \$ 28,985    |
| Cost of goods sold                         | 9,517              | 7,822        | 17,939           | 16,541       |
| Gross profit                               | 8,438              | 7,349        | 15,226           | 12,444       |
| Operating expenses                         |                    |              |                  |              |
| Selling, general and administrative        | 5,968              | 6,605        | 11,572           | 11,587       |
| Depreciation and amortization              | 87                 | 87           | 174              | 175          |
|  | 6,055              | 6,692        | 11,746           | 11,762       |
| Operating income                           | 2,383              | 657          | 3,480            | 682          |
| Interest expense                           | (167)              | (202)        | (359)            | (395)        |
| Other expense                              |                    | (28)         |                  | (25)         |
| Income before provision for taxes          | 2,216              | 427          | 3,121            | 262          |
| Income taxes                               | 201                | 5            | 263              | 13           |
| Net income                                 | \$ 2,015           | \$ 422       | \$ 2,858         | \$ 249       |
| <b>Earnings per common share - basic</b>   | \$ 0.03            | \$ 0.01      | \$ 0.05          | \$ 0.01      |
| <b>Earnings per common share - diluted</b> | \$ 0.03            | \$ 0.01      | \$ 0.05          | \$ 0.01      |
| Weighted average shares outstanding        |                    |              |                  |              |
| Basic                                      | 59,342             | 41,227       | 59,302           | 40,334       |
| Diluted                                    | 59,583             | 43,365       | 59,571           | 41,976       |

The accompanying notes are an integral part of these financial statements.

## JOE S JEANS INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

|  | Six months ended |               |
|--|------------------|---------------|
|  | May 31, 2008     | May 26, 2007  |
|  | (unaudited)      |               |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>          |                  |               |
| Net cash provided by (used in) operating activities  | \$ 2,432         | \$ (4,044)    |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>          |                  |               |
| Proceeds from sales of property and equipment        |                  | 2             |
| Payments for earnout on trademark                    | (701)            |               |
| Purchases of property and equipment                  | (120)            | (61)          |
| Net cash used in investing activities                | (821)            | (59)          |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>          |                  |               |
| Proceeds (net repayments) from factor borrowing, net | (391)            | 359           |
| Proceeds from issuance of common stock               |                  | 3,696         |
| Net cash (used in) provided by financing activities  | (391)            | 4,055         |
| <b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>       | <b>1,220</b>     | <b>(48)</b>   |
| CASH AND CASH EQUIVALENTS, at beginning of period    | 1,331            | 385           |
| <b>CASH AND CASH EQUIVALENTS, at end of period</b>   | <b>\$ 2,551</b>  | <b>\$ 337</b> |

The accompanying notes are an integral part of these financial statements.

## JOE S JEANS INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

(in thousands)

|  | Common Stock<br>Shares | Common Stock<br>Par Value | Additional<br>Paid-In Capital | Accumulated<br>Deficit | Treasury<br>Stock | Total<br>Stockholders<br>Equity |
|--|------------------------|---------------------------|-------------------------------|------------------------|-------------------|---------------------------------|
| <b>Balance, November 25, 2006</b>                    | 34,455                 | \$ 3,447                  | \$ 79,763                     | \$ (77,126)            | \$ (2,776)        | \$ 3,308                        |
| Net loss (unaudited)                                 |                        |                           |                               | 249                    |                   | 249                             |
| Stock-based compensation<br>(unaudited)              |                        |                           | 10                            |                        |                   | 10                              |
| Issuance of common stock and<br>warrants (unaudited) | 6,934                  | 694                       | 3,002                         |                        |                   | 3,696                           |
| <b>Balance, May 26, 2007 (unaudited)</b>             | 41,389                 | \$ 4,141                  | \$ 82,775                     | \$ (76,877)            | \$ (2,776)        | \$ 7,263                        |
| <b>Balance, November 30, 2007</b>                    | 59,862                 | \$ 5,988                  | \$ 102,056                    | \$ (74,872)            | \$ (2,776)        | \$ 30,396                       |
| Net income (unaudited)                               |                        |                           |                               | 2,858                  |                   | 2,858                           |
| Stock-based compensation<br>(unaudited)              |                        |                           | 434                           |                        |                   | 434                             |
| <b>Balance, May 31, 2008 (unaudited)</b>             | 59,862                 | \$ 5,988                  | \$ 102,490                    | \$ (72,014)            | \$ (2,776)        | \$ 33,688                       |

The accompanying notes are an integral part of these financial statements.



**JOE S JEANS INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1 - BASIS OF PRESENTATION**

The unaudited condensed consolidated financial statements of Joe s Jeans Inc., or Joe s, which include the accounts of its wholly-owned subsidiaries, for the three and six months ended May 31, 2008 and May 26, 2007 and the related footnote information have been prepared on a basis consistent with Joe s audited consolidated financial statements as of November 30, 2007 contained in Joe s Annual Report on Form 10-K and Amendment No. 1 to its Annual Report on Form 10-K/A for the year ended November 30, 2007, or collectively, the Annual Report.

Joe s principal business activity involves the design, development and worldwide marketing of apparel products. Joe s primary current operating subsidiary is Joe s Jeans Subsidiary Inc., or Joe s Jeans Subsidiary. All significant inter-company transactions have been eliminated. Currently, Joe s has only one segment of operations, primarily apparel, which includes an immaterial amount of revenue from a license agreement for accessories. On October 12, 2007, Joe s filed an amended and restated certificate of incorporation in Delaware to change its corporate name from Innovo Group Inc. to Joe s Jeans Inc. and to increase the shares of common stock authorized for issuance to 100,000,000.

Joe s fiscal year end is November 30. Effective October 11, 2007, Joe s changed from a thirteen-week quarterly reporting period to a last day of the month quarterly reporting period. This change was made to conform to standard quarterly accounting periods. Prior to the change in its fiscal year, Joe s fiscal year end was the Saturday closest to November 30 based upon a 52 week period and the quarterly periods consisted of 13 week periods based on a Sunday to Saturday week. Quarterly periods presented have six calendar months for the period ended May 31, 2008 and 26 weeks for the period ended May 26, 2007. The modification of the fiscal years and respective quarterly periods did not have a material effect on Joe s financial condition, results of operations or cash flows.

These unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the related notes thereto contained in Joe s Annual Report. In the opinion of management, the accompanying unaudited financial statements contain all adjustments (consisting of normal recurring adjustments), which management considers necessary to present fairly Joe s financial position, results of operations and cash flows for the interim periods presented. The results for the three and six months ended May 31, 2008 are not necessarily indicative of the results anticipated for the entire year ending November 30, 2008. The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements. Actual results may differ from those estimates.

**NOTE 2 ADOPTION OF ACCOUNTING PRINCIPLES**

On July 13, 2006, the Financial Accounting Standards Board, or FASB, issued Interpretation No. 48, or FIN No. 48, Accounting for Uncertainty in Income Taxes: An Interpretation of FASB Statement No. 109. This interpretation clarifies the accounting for and disclosure of uncertainty in income taxes recognized in an entity s financial statements in accordance with SFAS No. 109, Accounting for Income Taxes. This interpretation defines the criteria that must be met for the benefits of a tax position to



be recognized in the financial statements and the measurement of tax benefits recognized. The provisions of FIN 48 were effective for fiscal years beginning after December 15, 2006. Joe s adopted FIN 48 effective December 1, 2007. The adoption of FIN 48 did not have a material impact on its results of operations, consolidated financial position or cash flows.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements , or SFAS No. 157, which defines fair value, establishes a framework for measuring fair value and requires enhanced disclosures about fair value measurements. SFAS No. 157 requires companies to disclose the fair value of their financial instruments according to a fair value hierarchy (i.e., levels 1, 2, and 3, as defined). Additionally, companies are required to provide enhanced disclosure regarding instruments in the level 3 category, including a reconciliation of the beginning and ending balances separately for each major category of assets and liabilities. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. Joe s adopted SFAS No. 157 on December 1, 2007. Given the nature of Joe s current financial instruments, the adoption of SFAS No. 157 did not have a material impact on its results of operations or consolidated financial position.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115, or SFAS No. 159. SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. Unrealized gains and losses on items for which the fair value option has been elected will be recognized in earnings at each subsequent reporting date. SFAS No. 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007. Joe s adopted SFAS No. 159 on December 1, 2007. Given the nature of Joe s current financial instruments, the adoption of SFAS No. 159 did not have a material impact on its results of operations or consolidated financial position.

### NOTE 3 ACCOUNTS RECEIVABLE, INVENTORY ADVANCES AND DUE (TO) FACTOR

Joe s primary method to obtain the cash necessary for operating needs was through the sale of accounts receivable pursuant to factoring agreements and obtaining advances under inventory security agreements with its factor, CIT Commercial Services, Inc., a unit of CIT Group Inc., or CIT.

As a result of these agreements, amounts due to factor consist of the following (in thousands):

|  | May 31, 2008 |         | November 30, 2007 |         |
|--|--------------|---------|-------------------|---------|
| Non-recourse receivables assigned to factor          | \$           | 8,104   | \$                | 8,346   |
| Client recourse receivables                          |              | 858     |                   | 778     |
| Total receivables assigned to factor                 |              | 8,962   |                   | 9,124   |
| Allowance for customer credits and doubtful accounts |              | (1,437) |                   | (1,421) |
| Net loan balance from factored accounts receivable   |              | (7,221) |                   | (6,201) |
| Net loan balance from inventory advances             |              | (2,953) |                   | (4,542) |
| Due to factor  | \$           | (2,649) | \$                | (3,040) |
| Non-factored accounts receivable                     | \$           | 1,841   | \$                | 1,455   |
| Allowance for customer credits and returns           |              | (597)   |                   | (652)   |
| Accounts receivable, net of allowance                | \$           | 1,244   | \$                | 803     |



Of the total amount of receivables sold as of May 31, 2008 and November 30, 2007, Joe's bears the risk of payment of \$858,000 and \$778,000, respectively, in the event of non-payment by its customers.

*CIT Commercial Services*

On June 1, 2001, the Joe's Jeans Subsidiary entered into an accounts receivable factoring agreement and an inventory security agreement with CIT. In prior years, Joe's other active subsidiaries also entered into substantially identical agreements. These agreements give Joe's the ability to obtain cash by selling to CIT certain of its accounts receivable and advances for up to 50 percent of the value of certain eligible inventory. The accounts receivables are sold for up to 85 percent of the face amount on either a recourse or non-recourse basis depending on the creditworthiness of the customer. CIT currently permits Joe's to sell its accounts receivables at the maximum level of 85 percent and allows advances of up to \$6,000,000 for eligible inventory. CIT has the ability, in its discretion at any time or from time to time, to adjust or revise any limits on the amount of loans or advances made to Joe's pursuant to these agreements. As further assurance to CIT, cross guarantees were executed by and among Joe's and all of its subsidiaries to guarantee each subsidiaries' obligations.

As of May 31, 2008, Joe's cash availability with CIT was approximately \$323,000. This amount fluctuates on a daily basis based upon invoicing and collection related activity by CIT for the receivables sold. In connection with the agreements with CIT, certain assets are pledged to CIT, including all of the inventory, merchandise, and/or goods, including raw materials through finished goods and receivables.

The agreements may be terminated by CIT upon 60 days' written notice or immediately upon the occurrence of an event of default as defined in the agreement. The agreements may be terminated by Joe's upon 60 days' written notice prior to June 30, 2010 or earlier provided that the minimum factoring fees have been paid for the respective period.

The factoring rate that Joe's pays to CIT to factor accounts is at 0.6 percent for accounts which CIT bears the credit risk and 0.4 percent for accounts which Joe's bears the credit risk and the interest rate associated with borrowings under the inventory lines and factoring facility is at 0.25 percent plus the Chase prime rate. As of May 31, 2008, the Chase prime rate was five percent.

In addition, in the event Joe's needs additional funds, Joe's has also established a letter of credit facility with CIT to allow it to open letters of credit for a fee of 0.25 percent of the letter of credit face value with international and domestic suppliers, subject to availability. At May 31, 2008, Joe's had 12 letters of credit outstanding in the aggregate amount of \$310,000.

**NOTE 4 INVENTORIES**

Inventories are valued at the lower of cost or market with cost determined by the first-in, first-out method. Inventories consisted of the following (in thousands):



## Edgar Filing: JOE'S JEANS INC. - Form 10-Q

|   | May 31, 2008 | November 30, 2007 |
|---|--------------|-------------------|
| Finished goods  | \$ 7,492     | \$ 7,450          |
| Work in progress                                      | 1,614        | 1,998             |
| Raw materials   | 10,690       | 11,969            |
|   | 19,796       | 21,417            |
| Less allowance for obsolescence and slow moving items | (1,103)      | (614)             |
|   | \$ 18,693    | \$ 20,803         |

Joe's recorded charges to its inventory reserve allowance of \$0 and \$197,000 for the three months ended May 31, 2008 and May 26, 2007, respectively, and \$22,000 and \$197,000 for the six months ended May 31, 2008 and May 26, 2007, respectively.

### NOTE 5 - MERGER TRANSACTION

#### *Merger Agreement*

Joe's, Joe's Subsidiary, JD Holdings, Inc., or JD Holdings, and Joseph Dahan, the sole stockholder of JD Holdings, entered into a definitive Agreement and Plan of Merger on February 6, 2007, as amended on June 25, 2007, or the Merger Agreement. JD Holdings primary asset was all rights, title and interest in all intellectual property, including the trademarks, related to the Joe's®, Joe's Jeans and JD brand and marks, or the Joe's Brand. At the time of entering into the Merger Agreement, Mr. Dahan was a current employee of Joe's, serving as president of Joe's Subsidiary. In addition, JD Holdings was the successor to JD Design, the entity from whom Joe's licensed the Joe's Brand. The license agreement terminated automatically upon completion of the merger.

Under the terms and subject to the conditions set forth in the Merger Agreement, on October 25, 2007, Joe's and JD Holdings completed the merger. In connection with the merger, Joe's Subsidiary merged with and into JD Holdings, with Joe's Subsidiary as the surviving entity. In addition, Joe's issued 14,000,000 shares of its common stock, made a cash payment of \$300,000 to JD Holdings in exchange for all of its outstanding shares and incurred \$93,000 of merger related expenses. As a result of the merger, Joe's now owns all rights, title and interest in the Joe's Brand.

Under the revised Merger Agreement, Mr. Dahan will be entitled to, for a period of 120 months following October 25, 2007, a certain percentage of the gross profit earned by Joe's in any applicable fiscal year. See Note 0 Commitments and Contingencies Earn Out for a further discussion of the earn-out obligation. In addition, the Merger Agreement contains a restrictive covenant relating to non-competition and non-solicitation for one year following the termination of Mr. Dahan's service.

Upon completion of the merger, on October 25, 2007, Mr. Dahan became an officer, director and greater than 10 percent stockholder of Joe's and an Employment Agreement and Investor Rights Agreement became effective.

The merger has been accounted for as a purchase under U.S. generally accepted accounting principles. Accordingly, management, with the assistance from independent valuation specialists, has allocated the purchase price to the assets and liabilities of JD Holdings in Joe's financial statements as of the completion of the merger at their respective fair values.





The assets acquired in this merger consisted of intangible assets. JD Holdings had an immaterial amount of other assets, including incidental office equipment that was distributed to Mr. Dahan as the sole stockholder prior to the closing of the transaction. Pursuant to the Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets, Joe's has determined that the useful life of the acquired assets is indefinite and therefore no amortization expense will initially need to be recognized. However, Joe's will test the assets for impairment annually and/or if events or changes in circumstances indicate that the assets might be impaired. Additionally, a deferred tax liability has been established in the allocation of the purchase price with respect to the identified indefinite long lived intangible assets acquired and advanced earn-out payments are recorded as additional goodwill. For the six months ended May 31, 2008, Joe's has recorded \$701,000 as additional goodwill.

#### *Employment Agreement*

In connection with the completion of the merger, an employment agreement automatically became effective upon the closing of the merger for Mr. Dahan to serve as Creative Director for the Joe's Brand.

The initial term of employment is five years with automatic renewals for successive one year periods thereafter, unless terminated earlier in accordance with the agreement. Under the employment agreement, Mr. Dahan is entitled to an annual salary of \$300,000 and other discretionary benefits that the Compensation Committee of the Board of Directors may deem appropriate in its sole and absolute discretion.

Under the terms of the employment agreement, Joe's may terminate Mr. Dahan for cause or if he becomes disabled, as defined in the agreement. Should Joe's terminate Mr. Dahan's employment for cause or disability, Joe's would only be required to pay him through the date of termination. Joe's may terminate Mr. Dahan's employment without cause at any time upon two weeks notice, provided that it pays to him the present value of the annual salary amounts otherwise due to him for the remainder of the initial term of employment or any renewal term. Mr. Dahan may terminate his employment for good reason at any time within 30 days written notice. In the event that Mr. Dahan terminates his employment for good reason, then he will be entitled to the present value of the annual salary amounts otherwise due to him for the remainder of the term of employment. Further, Mr. Dahan may terminate his employment for any reason upon ten business days' notice and only be entitled to his salary as of the date of termination on a pro rata basis.

The employment agreement contains customary terms and conditions related to confidentiality of information, ownership by Joe's of all intellectual property, including future designs and trademarks, alternative dispute resolution and Mr. Dahan's duties and responsibilities to Joe's and the Joe's Brand as Creative Director.

#### *Investor Rights Agreement*

Upon the closing of the merger, Joe's also entered into an investor rights agreement. Pursuant to the investor rights agreement, Joe's agreed to register for resale, on a periodic basis at the request of Mr. Dahan, the shares of common stock eligible for resale issued in connection with the merger. The shares of common stock issued as merger consideration become eligible for resale beginning on the six month anniversary of the closing date of the merger at an initial rate of 1/6 of the shares issued and every six months thereafter at the same rate until all the shares are fully released on the third anniversary of the closing date. Joe's agreed to bear all expenses associated with registering these shares for resale and have granted to Mr. Dahan certain piggyback rights with respect to future registration statements filed by Joe's. The investor rights agreement contains customary terms and conditions related to registration procedures,



trading suspensions and indemnification of the parties. On March 24, 2008, a registration statement on Form S-3 was declared effective for the resale of up to 2,333,333 shares held by Mr. Dahan. His contractual restrictions on resale for those shares lapsed on April 25, 2008.

#### **NOTE 6 RELATED PARTY TRANSACTIONS**

*JD Holdings Inc.*

On February 7, 2001, Joe's acquired a license for the rights to the Joe's Brand from JD Design LLC, which was subsequently merged with and into JD Holdings. Under the license agreement, JD Holdings was entitled to a royalty of three percent on net sales of licensed products. In October 2005, Joe's granted JD Holdings the right to develop the children's branded apparel line under an amendment to its master license agreement in exchange for a five percent royalty on net sales of those products. On October 25, 2007, in connection with the merger, the license agreement terminated.

As part of the consideration paid in connection with the completion of the merger, Mr. Dahan is entitled to a certain percentage of the gross profit earned by Joe's in any applicable fiscal year until October 2017. See Note 5 Merger Transaction and Note 10 Commitment and Contingencies for a further discussion on the merger agreement and the earn-out. For the six months ended May 31, 2008, Joe's paid \$701,000 in earn-out payments to Mr. Dahan, which it has recorded as additional goodwill.

As a related party, Mr. Dahan's brother is the managing member of a company Shipson LLC, or Shipson, to whom Joe's outsourced its E-shop on its Joe's Jeans website. Joe's sold its Joe's® products to Shipson at its wholesale price on normal and customary terms and conditions to fulfill purchases by customers on the E-shop. Joe's ceased doing business with Shipson in February 2008. As of May 31, 2008, Shipson currently owes \$192,000 to Joe's for outstanding purchase orders and this amount has been fully reserved for in its financial statements.

#### **NOTE 7 EARNINGS PER SHARE**

Earnings per share are computed using weighted average common shares and dilutive common equivalent shares outstanding. Potentially dilutive securities consist of outstanding options and warrants. A reconciliation of the numerator and denominator of basic earnings per share and diluted earnings per share is as follows:

Edgar Filing: JOE'S JEANS INC. - Form 10-Q

|  | Three months ended<br>(in thousands, except per share data) |              | Six months ended<br>(in thousands, except per share data) |              |
|--|---|--------------|---|--------------|
|  | May 31, 2008  | May 26, 2007 | May 31, 2008  | May 26, 2007 |
| <b>Basic earnings per share computation:</b>   |   |              |   |              |
| Numerator:                                     |   |              |   |              |
| Net income                                     | \$ 2,015  | \$ 422       | \$ 2,858  | \$ 249       |
| Denominator:                                   |   |              |   |              |
| Weighted average common shares outstanding     | 59,342  | 41,227       | 59,302  | 40,334       |
| <b>Income per common share - basic</b>         |   |              |   |              |
| Net income                                     | \$ 0.03   | \$ 0.01      | \$ 0.05   | \$ 0.01      |
| <b>Diluted earnings per share computation:</b> |   |              |   |              |
| Numerator:                                     |   |              |   |              |
| Net income                                     | \$ 2,015  | \$ 422       | \$ 2,858  | \$ 249       |
| Denominator:                                   |   |              |   |              |
| Weighted average common shares outstanding     | 59,342  | 41,227       | 59,302  | 40,334       |
| Effect of dilutive securities:                 |   |              |   |              |
| Options and warrants                           | 241   | 2,138        | 269   | 1,642        |
| Dilutive potential common shares               | 59,583  | 43,365       | 59,571  | 41,976       |
| <b>Income per common share - dilutive</b>      |   |              |   |              |
| Net income                                     | \$ 0.03   | \$ 0.01      | \$ 0.05   | \$ 0.01      |

Potentially dilutive options, warrants, restricted stock and restricted stock units in the aggregate of 3,454,592 and 2,131,637 for both the three and six months ended May 31, 2008 and May 26, 2007, respectively, have been excluded from the calculation of the diluted income per share, as their effect would have been anti-dilutive.

*Shares Reserved for Future Issuance*

As of May 31, 2008, shares reserved for future issuance include (i) 3,301,046 shares of common stock issuable upon the exercise of stock options granted under the incentive plans; (ii) 706,100 shares of common stock issuable upon the vesting of restricted stock units; (iii) an aggregate of 3,414,890 shares of common stock available for future issuance under the 2004 Stock Incentive Plan as of May 31, 2008; and (iv) 1,383,333 shares of common stock issuable upon the exercise of outstanding warrants.

**NOTE 8 INCOME TAXES**

Joe's utilizes the liability method of accounting for income taxes in accordance with SFAS No. 109. Under the liability method, deferred taxes are determined based on the temporary differences between the financial statement and tax bases of assets and liabilities using enacted tax rates.

Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized. The likelihood of a material change in Joe's expected realization of these assets depends on its ability to generate sufficient future taxable income. Joe's ability to generate enough taxable income to utilize its deferred tax assets depends on many factors, among which is Joe's ability to deduct tax loss carry-forwards against future taxable income, the effectiveness of tax planning strategies and reversing deferred tax liabilities.

Edgar Filing: JOE'S JEANS INC. - Form 10-Q

In June 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement 109 , or FIN No. 48. FIN No. 48 establishes a single model to address accounting for uncertain tax positions. FIN No. 48 clarifies the accounting for income taxes by prescribing a minimum recognition threshold a tax position is required to meet before

being recognized in the financial statements. FIN No. 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. Joe's adopted the provisions of FIN No. 48 on December 1, 2007. Upon adoption, Joe's did not recognize an adjustment in the amount of unrecognized tax benefits. As of the date of adoption, Joe's had no unrecognized tax benefits. Joe's policy is to recognize interest and penalties that would be assessed in relation to the settlement value of unrecognized tax benefits as a component of income tax expense.

Joe's and its subsidiaries are subject to U.S. federal income tax as well as income tax in multiple state jurisdictions. To the extent allowed by law, the tax authorities may have the right to examine prior periods where net operating losses were generated and carried forward, and make adjustments up to the amount of the net operating loss carryforward amount. Joe's is not currently under an Internal Revenue Service tax examination or an examination by any other state, local or foreign jurisdictions.

Joe's recorded an income tax expense of \$201,000 and \$5,000 for the three months ended May 31, 2008, and May 26, 2007, respectively, and \$263,000 and \$13,000 for the six months ended May 31, 2008, and May 26, 2007, respectively. Joe's effective tax rate was eight percent for the six months ended May 31, 2008 and one percent for the six months ended May 26, 2007. For the three and six months ended May 31, 2008 and May 26, 2007, the difference between the effective tax rate and the statutory rate is primarily attributable to the utilization of net operation loss tax carryforwards against which a full valuation allowance has been established.

## NOTE 9 STOCKHOLDERS EQUITY

### *Warrants*

Joe's has issued warrants in conjunction with various private placements of its common stock, and debt to equity conversions. All warrants are currently exercisable. As of May 31, 2008, outstanding common stock warrants are as follows:

| Exercise price | Shares    | Issued        | Expiration    |
|----------------|-----------|---------------|---------------|
| \$ 4.50        | 200,000   | June 2003     | June 2008     |
| 3.62           | 17,500    | August 2003   | August 2008   |
| 4.00           | 373,333   | November 2003 | November 2008 |
| 1.53           | 125,000   | June 2004     | June 2009     |
| 2.28           | 62,500    | October 2004  | October 2009  |
| 0.66           | 125,000   | December 2006 | December 2011 |
| 1.36           | 480,000   | June 2007     | June 2012     |
|                | 1,383,333 |               |               |

### *Stock Incentive Plans*

In March 2000, Joe's adopted the 2000 Employee Stock Option Plan, or the 2000 Employee Plan. In connection with stockholder approval of the 2004 Stock Incentive Plan, Joe's stated that it would no longer grant options pursuant to the 2000 Employee Plan. In December 2007, the outstanding options remaining under the 2000 Employee Plan expired and the 2000 Employee Plan automatically terminated.



In September 2000, Joe's adopted the 2000 Director Stock Incentive Plan, or the 2000 Director Plan, under which nonqualified stock options were granted to members of the Board of Directors in lieu of cash director fees. After the adoption of the 2004 Stock Incentive Plan in June 2004, Joe's no longer granted options pursuant to the 2000 Director Plan; however, it remains in effect for awards outstanding as of the adoption of the 2004 Stock Incentive Plan. As of May 31, 2008, options to purchase up to 203,546 remained outstanding under the 2000 Director Plan.

On June 3, 2004, Joe's adopted the 2004 Stock Incentive Plan, or the 2004 Incentive Plan, and has subsequently amended it to increase the number of shares authorized for issuance to 8,265,172 shares of common stock. Under the 2004 Incentive Plan, grants may be made to employees, officers, directors and consultants under a variety of awards based upon underlying equity, including, but not limited to, stock options, restricted common stock, restricted stock units or performance shares. The 2004 Incentive Plan limits the number of shares that can be awarded to any employee in one year to 1,250,000. Exercise price for incentive options may not be less than the fair market value of Joe's common stock on the date of grant and the exercise period may not exceed ten years. Vesting periods, terms and types of awards are determined by the Board of Directors and/or its Compensation and Stock Option Committee, or Compensation Committee. The 2004 Incentive Plan includes a provision for the acceleration of vesting of all awards upon a change of control as well as a provision that allows forfeited or unexercised awards that have expired to be available again for future issuance. During the fourth quarter of fiscal 2007, Joe's granted 555,849 shares of restricted common stock to its directors and CEO pursuant to the 2004 Stock Incentive Plan. In December 2007, Joe's issued 745,600 restricted common stock units, or RSUs, to its employees pursuant to the 2004 Stock Incentive Plan. These RSUs represent the right to receive one share of common stock for each unit on the vesting date provided that the employee continues to be employed by Joe's. The RSUs vest ratably every six months with the first tranche vested on June 18, 2008 until all of the RSUs are vested on December 18, 2011. On the vesting date, Joe's expects to issue the shares of common stock to each employee that he or she is vested in and expects to withhold an equivalent number of shares at fair market value on the vesting date to fulfill each employee's minimum tax withholding obligation. On June 18, 2008, Joe's issued 58,563 shares of its common stock to the holders of RSUs. In the fourth quarter of fiscal 2007, Joe's granted an option to purchase 100,000 shares that vested on a monthly basis over a two year period; however, this option was cancelled and replaced with the consent of the option holder with RSUs for 100,000 shares of common stock in December 2007. As of May 31, 2008, 39,500 RSUs have been forfeited by employees.

The shares of common stock issued upon exercise of a previously granted stock option or a grant of restricted common stock or RSUs are considered new issuances from shares reserved for issuance in connection with the adoption of the various plans. Joe's requires that the option holder provide a written notice of exercise in accordance with the option agreement and plan to the stock plan administrator and full payment for the shares be made prior to issuance. All issuances are made under the terms and conditions set forth in the applicable plan. As of May 31, 2008, 3,414,890 shares remained available for issuance under the 2004 Incentive Plan.

For all stock compensation awards that contain graded vesting with time-based service conditions, Joe's has elected to apply a straight-line recognition method to account for all of these awards. For existing grants that were not fully vested at November 30, 2007, there was a total of \$434,000 of stock based compensation expense recognized in the first and second quarters of fiscal 2008.

The following summarizes option grants and restricted common stock issued to members of the Board of Directors for the fiscal years 2002 through the second quarter of fiscal 2008 (in actual amounts) for service as a member:



Edgar Filing: JOE'S JEANS INC. - Form 10-Q

| As of: | May 31, 2008      |                |
|--------|-------------------|----------------|
|        | Number of options | Exercise price |
| 2002   | 40,000            | \$ 1.00        |
| 2002   | 31,496            | \$ 1.27        |
| 2003   | 30,768            | \$ 1.30        |
| 2004   | 320,000           | \$ 1.58        |
| 2005   | 300,000           | \$ 5.91        |
| 2006   | 450,000           | \$ 1.02        |
| 2007   |                   |                |
| 2008   |                   |                |

|      | Number of restricted shares issued |
|------|------------------------------------|
| 2007 | 320,000                            |
| 2008 |                                    |

Stock activity in the aggregate for the periods indicated are as follows (in actual amounts):

|   | Options   | Weighted average exercise price | Weighted average remaining contractual Life (Years) | Aggregate Intrinsic Value |
|---|-----------|---------------------------------|---|---------------------------|
| Outstanding at November 30, 2007  | 3,626,046 | \$ 1.80                         |   |                           |
| Granted   |           |                                 |   |                           |
| Exercised   |           |                                 |   |                           |
| Expired   | (200,000) | 2.40                            |   |                           |
| Forfeited   | (100,000) | 1.98                            |   |                           |
| Outstanding at May 31, 2008   | 3,326,046 | \$ 1.76                         | 6.2   | \$ 205,240                |
| Exercisable and vested at May 31, 2008                                    | 3,301,046 | \$ 1.77                         | 6.2   | \$ 189,009                |
| Weighted average per option fair value of options granted during the year |           | N/A                             |   |                           |

|   | Options   | Weighted average exercise price | Weighted average remaining contractual Life (Years) | Aggregate Intrinsic Value |
|---|-----------|---------------------------------|---|---------------------------|
| Outstanding at November 26, 2006  | 4,092,296 | \$ 1.68                         |   |                           |
| Granted   |           |                                 |   |                           |
| Exercised   | (100,000) | 1.02                            |   |                           |
| Expired   |           |                                 |   |                           |
| Forfeited   | (200,000) | 1.02                            |   |                           |
| Outstanding at May 26, 2007   | 3,792,296 | \$ 1.73                         | 7.5   | \$ 453,151                |
| Exercisable and vested at May 26, 2007                                    | 3,692,296 | \$ 1.77                         | 7.5   | \$ 375,151                |
| Weighted average per option fair value of options granted during the year |           | N/A                             |   |                           |

Edgar Filing: JOE'S JEANS INC. - Form 10-Q

As of May 31, 2008, there was \$1,305,000 of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the 2004 Incentive Plan. That unrecognized compensation cost is expected to be recognized over a weighted-average period of three years. The total fair value of shares of stock options vested during the three months ended May 31, 2008, and May 26, 2007 was \$5,000 and \$5,000, respectively, and \$216,000 for restricted common stock during the three months ended May 31, 2008. The total fair value of shares of stock options vested during the six months ended May 31, 2008, and May 26, 2007 was \$12,000 and \$10,000, respectively, and \$422,000 for restricted common stock during the six months ended May 31, 2008.

Exercise prices for options outstanding as of May 31, 2008 are as follows:

| Exercise Price  | Number of shares | Options Outstanding                         |                          | Options Exercisable                         |                          |
|-----------------|------------------|---|--------------------------|---|--------------------------|
|                 |                  | Weighted-Average Remaining Contractual Life | Number of options vested | Weighted-Average Remaining Contractual Life | Number of options vested |
| \$0.39 - \$0.41 | 190,064          | 5.2   | 165,064                  | 4.7   |                          |
| \$1.00 - \$1.02 | 2,015,000        | 6.1   | 2,015,000                | 6.1   |                          |
| \$1.27 - \$1.30 | 60,982           | 4.7   | 60,982                   | 4.7   |                          |
| \$1.58 - \$1.63 | 610,000          | 6.2   | 610,000                  | 6.2   |                          |
| \$ 5.91         | 450,000          | 7.0   | 450,000                  | 7.0   |                          |
|                 | 3,326,046        | 6.2   | 3,301,046                | 6.2   |                          |

The following table summarizes the stock option activity by plan.

|                                  | Total Number of Shares | 2004 Incentive Plan | 2000 Employee Plan | 2000 Director Plan |
|----------------------------------|------------------------|---------------------|--------------------|--------------------|
| Outstanding at November 30, 2007 | 3,626,046              | 3,222,500           | 200,000            | 203,546            |
| Granted                          |                        |                     |                    |                    |
| Exercised                        |                        |                     |                    |                    |
| Forfeited / Cancelled            | (300,000)              | (100,000)           | (200,000)          |                    |
| Outstanding at May 31, 2008      | 3,326,046              | 3,122,500           |                    | 203,546            |
| Exercisable at May 31, 2008      | 3,301,046              | 3,097,500           |                    | 203,546            |

There were no options granted or exercised in the first or second quarters of fiscal 2008.

## Edgar Filing: JOE'S JEANS INC. - Form 10-Q

A summary of the status of restricted common stock and RSUs as of November 30, 2007, and changes during the six months ended May 31, 2008, is presented below:

|                                  | Restricted<br>Shares | Restricted Stock<br>Units | Total Shares | Weighted-Average Grant-Date Fair<br>Value |                           |
|----------------------------------|----------------------|---------------------------|--------------|---|---------------------------|
|                                  |                      |                           |              | Restricted<br>Shares                      | Restricted Stock<br>Units |
| Outstanding at November 30, 2007 | 529,182              |                           | 529,182      | \$ 1.59                                   | \$                        |
| Granted                          |                      | 745,600                   | 745,600      |   | 1.46                      |
| Vested                           | (160,000)            |                           | (160,000)    | (1.59)                                    |                           |
| Forfeited                        |                      | (39,500)                  | (39,500)     |   | (1.46)                    |
| Outstanding at May 31, 2008      | 369,182              | 706,100                   | 1,075,282    | \$ 1.59                                   | \$ 1.46                   |

### NOTE 10 COMMITMENTS AND CONTINGENCIES

#### *Earn Out*

As part of the consideration paid in connection with the completion of the merger, Mr. Dahan will be entitled to a certain percentage of the gross profit earned by Joe's in any applicable fiscal year until October 2017. Mr. Dahan will be entitled to the following: (i) 11.33 percent of the gross profit from \$11,251,000 to \$22,500,000; plus (ii) three percent of the gross profit from \$22,501,000 to \$31,500,000; plus (iii) two percent of the gross profit from \$31,501,000 to \$40,500,000; plus (iv) one percent of the gross profit above \$40,501,000. The payments will be paid in advance on a monthly basis based upon estimates of gross profits after the assumption has been reached that the payments will likely be paid. At the end of each quarter, any overpayments will be offset against future payments and any significant underpayments will promptly be made. No payment will be made if the gross profit is less than \$11,250,000. Gross Profit is defined as net sales of the Joe's® brand less cost of goods sold as reported in periodic filings with the SEC.

#### *Retail Leases*

In January 2008, Joe's entered into a lease agreement for the lease of retail space at Woodbury Common Premium Outlets® in Central Valley, New York. Under the lease agreement, Joe's takes possession of the space on August 1, 2008 and expects to open its retail outlet in the fall of 2008. The term of the lease is for 10 years and the annual base rent be \$147,000 plus an obligation to pay certain advertising fees, operating costs charges, a percentage rent based upon sales and other customary charges for retail leased space. The rent and other operating charges will increase at a fixed rate or based upon inflation after the first year and thereafter until the end of the term.

In March 2008, Joe's entered into a lease agreement for the lease of retail space at Orlando Premium Outlets® in Orlando, Florida. Under the lease agreement, Joe's takes possession of the space on September 1, 2008 and expects to open its retail outlet in the fall of 2008. The term of the lease is for 10 years and the annual base rent is \$179,000 plus an obligation to pay certain advertising fees, operating costs charges, a percentage rent based upon sales and other customary charges for retail leased space. The rent and other operating charges will increase at a fixed rate or based upon inflation after the first year and thereafter until the end of the term.

## Edgar Filing: JOE'S JEANS INC. - Form 10-Q

In April 2008, Joe's entered into a lease agreement for the lease of retail space in Chicago, Illinois. Under the lease agreement, Joe's takes possession of the space in July 2008 and expects to open its retail store in the fall of 2008. The term of the lease is for 10 years and the annual base rent is \$119,000 plus an obligation to pay certain advertising fees, operating costs charges and other customary charges. Operating expenses will be passed through to Joe's at a fixed rate for the first year and then increase thereafter until the end of the term.

**NOTE 11 SEASONALITY**

The market for apparel products is seasonal. The majority of Joe's sales activities take place from late fall to early spring and the greatest volume of shipments and sales are generally made from late spring through the summer. This time period coincides with Joe's second and third fiscal quarters and its cash flow is generally strongest in its third and fourth fiscal quarters when a significant amount of its net sales are realized as a result of shipping orders taken during earlier months. In the second quarter in order to prepare for peak sales that occur during the second half of the year, Joe's builds its inventory levels, which results in higher liquidity needs compared to other quarters.

Due to the seasonality of its business, as well as the evolution and changes in its business and product mix, Joe's quarterly or yearly results are not necessarily indicative of the results for the next quarter or year.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

**Forward-Looking Statements**

When used in this Quarterly Report on Form 10-Q, or Quarterly Report, the words may, will, expect, anticipate, intend, estimate, continue, believe and similar expressions are intended to identify forward-looking statements. Similarly, statements that describe our future expectations, objectives and goals or contain projections of our future results of operations or financial condition are also forward-looking statements. Statements looking forward in time are included in this Quarterly Report pursuant to the safe harbor provision of the Private Securities Litigation Reform Act of 1995. Such statements are subject to certain risks and uncertainties, which could cause actual results to differ materially, including, without limitation, continued acceptance of our product, product demand, competition, capital adequacy and the potential inability to raise additional capital if required, and the risk factors contained in our reports filed with the Securities and Exchange Commission, or SEC, pursuant to the Securities Exchange Act of 1934, as amended, including our Annual Report on Form 10-K for the year ended November 30, 2007 and Amendment No. 1 to our Annual Report of Form 10-K/A, or collectively, the Annual Report. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. Our future results, performance or achievements could differ materially from those expressed or implied in these forward-looking statements. We do not undertake and specifically decline any obligation to publicly revise these forward-looking statements to reflect events or circumstances occurring after the date hereof or to reflect the occurrence of unanticipated events.

The following discussion provides information and analysis of our results of operations for the three and six month periods ended May 31, 2008 and May 26, 2007, and our liquidity and capital resources. The following discussion and analysis should be read in conjunction with our notes to our accompanying condensed consolidated financial statements included elsewhere herein.

**Introduction**

This discussion and analysis summarizes the significant factors affecting our results of operations and financial condition during the three and six month periods ended May 31, 2008 and May 26, 2007. This discussion should be read in conjunction with our accompanying condensed consolidated financial statements, our notes to condensed consolidated financial statements and supplemental information in Item 1 of this Quarterly Report. The discussion and analysis contains statements that may be considered forward-looking. These statements contain a number of risks and uncertainties as discussed here, under the heading Forward-Looking Statements of this Quarterly Report that could cause actual results to differ materially.

**Executive Overview**

Our principal business activity has evolved into the design, development and worldwide marketing of Joe's® products, which include denim jeans, related casual wear and accessories. Since Joe's® was established in 2001, the brand is recognized in the premium denim industry, an industry term for denim jeans with price points of \$120 or more, for its quality, fit and fashion-forward designs. Because we focus on design, development and marketing, we rely on third parties to manufacture our apparel products and for distribution and product fulfillment services. We sell our products to numerous retailers, which include major department stores, specialty stores and distributors around the world. Historically, we sold other branded apparel products, such as indie, Betsey Johnson®, Fetish and Shago®, private label denim and denim related products and craft and accessory products. Since fiscal 2006, we have not had any sales of these other products.



In fiscal 2007, we continued to implement our transition plan to focus our operations on our Joe's® brand after we sold the assets or ceased operations of our other branded and private label apparel and accessory products. To enhance our ability to capitalize on the Joe's® brand, on February 6, 2007, we entered into a merger agreement to merge with JD Holdings Inc., or JD Holdings, the successor in interest to JD Design LLC, or JD Design, the entity from whom we licensed the Joe's® brand. We also entered into our first license agreement for other product categories for handbags, belts and small leather goods bearing the Joe's® brand to be effective upon completion of the merger. In October 2007, we completed the merger and acquired the Joe's® brand. In exchange for all of the rights for the Joe's® brand, we issued 14,000,000 shares of our common stock, \$300,000 in cash and entered into an employment agreement with Joe Dahan, the principal designer and sole stockholder of JD Holdings. As part of the merger consideration, we are also obligated to pay Mr. Dahan a percentage of our gross profits until 2017 above \$11,251,000. In addition to owning approximately 24 percent of our total shares outstanding, after the merger, Mr. Dahan became an executive officer and a member of our Board of Directors.

We reported net income for the full fiscal year of 2007 for the first time since 2002 and have also reported net income for the past five consecutive quarters. While we have strived to reduce costs and implement cost saving measures in order to generate net income, there can be no assurance that we can continue to improve our net sales, gross profit or maintain expenses in order to continue to generate net income. Our strategic plan for the remainder of 2008 and 2009 includes entering into lease agreements to open retail and outlet stores, improving international sales, increasing sales from our men's and children's product lines, evaluating licensing opportunities for other product categories and enhancing the quality, fit and products available in our collection beyond denim bottoms. In the first half of fiscal 2008, we entered into two leases for retail outlet space at Woodbury Common Premium Outlets® in Central Valley, New York and Orlando Premium Outlets® in Orlando, Florida and one lease for a full price retail store in Chicago, Illinois. We expect to open the stores in the fall of 2008. We believe that the outlet store strategy will allow us to sell our overstock or slow moving items at better profit margins. We are actively looking for other retail leases for fiscal 2009 and beyond. In addition, we have been focusing on designing an entire collection of products to be available and showcased in retail stores. Since early 2007, we have had two consultants based in Europe to assist us in entering into agent and distributor agreements worldwide to assist us in improving our international sales and strategically grow international sales. We feel that direct contact with agents and distributors will give us better control over their management and direction.

Our business is seasonal. The majority of the marketing and sales activities take place from late fall to early spring. The greatest volume of shipments and sales are generally made from late spring through the summer, which coincides with our second and third fiscal quarters and our cash flow is strongest in our third and fourth fiscal quarters. Due to the seasonality of our business, as well as the evolution and changes in our business and product mix, often our quarterly or yearly results are not necessarily indicative of the results for the next quarter or year.

In October 2007, we changed our fiscal year end from a thirteen-week quarterly reporting period to a last day of the month quarterly reporting period to reflect standard quarterly accounting periods. The modification of the fiscal year or quarters did not have a material effect on our financial condition, results of operations or cash flows.



**Results of Operations**

The following table sets forth certain statements of operations data for the periods as indicated:

|                                   | <b>Three months ended</b><br><b>(dollar values in thousands)</b> |                     |                  |                 |
|-----------------------------------|--|---------------------|------------------|-----------------|
|                                   | <b>May 31, 2008</b>  | <b>May 26, 2007</b> | <b>\$ Change</b> | <b>% Change</b> |
| Net sales                         | \$ 17,955  | \$ 15,171           | \$ 2,784         | 18%             |
| Cost of goods sold                | 9,517  | 7,822               | 1,695            | 22%             |
| Gross profit                      | 8,438  | 7,349               | 1,089            | 15%             |
| Gross margin                      | 47%  | 48%                 |                  |                 |
| Selling, general & administrative | 5,968  | 6,605               | (637)            | (10)%           |
| Depreciation & amortization       | 87   | 87                  |                  |                 |
| Income from operations            | 2,383  | 657                 | 1,726            | 263%            |
| Interest expense                  | (167)  | (202)               | 35               | (17)%           |
| Other income (expense)            |  | (28)                | 28               | (100)%          |
| Income before provision for taxes | 2,216  | 427                 | 1,789            | 419%            |
| Income taxes                      | 201  | 5                   | 196              | 3,920%          |
| <b>Net income</b>                 | <b>\$ 2,015</b>  | <b>\$ 422</b>       | <b>\$ 1,593</b>  | <b>377%</b>     |

**Comparison of Three Months Ended May 31, 2008 to Three Months Ended May 26, 2007****Three Months Ended May 31, 2008 Overview**

For the three months ended May 31, 2008, or the second quarter of fiscal 2008, our net sales increased to \$17,955,000 from \$15,171,000 for the three months ended May 26, 2007, or the second quarter fiscal 2007, an 18 percent increase. We generated net income in the amount of \$2,015,000 for the second quarter of fiscal 2008 compared to \$422,000 for the second quarter of fiscal 2007.

The primary reasons for the increase in net income from the second quarter of fiscal 2008 compared to the second quarter of fiscal 2007 were the following:

- An increase of \$2,784,000, or 18 percent, in our net sales due to continued demand for denim in the marketplace;
- An increase of \$1,089,000, or 15 percent, in our gross profit;
- A decrease of \$637,000, or 10 percent, in our selling, general & administrative expenses; and

- A decrease of \$35,000, or 17 percent, in our interest expense.

**Net Sales**

Our net sales increased to \$17,955,000 for the second quarter of fiscal 2008 from \$15,171,000 for the second quarter of fiscal 2007, an 18 percent increase. This increase can be attributed to a continued (i) growth in the number of specialty stores and department store doors carrying our products from the second quarter of fiscal 2007 to fiscal 2008, (ii) strong demand for denim apparel products in the marketplace, (iii) brand acceptance and recognition for Joe's® products, and (iv) growth from European sales and from our recently introduced men's and children's product lines.

### **Gross Profit**

Our gross profit increased to \$8,438,000 for the second quarter of fiscal 2008 from \$7,349,000 for the second quarter of fiscal 2007, a 15 percent increase. Our overall gross margin decreased to 47 percent for the second quarter of fiscal 2008 from 48 percent for the second quarter of fiscal 2007, a one percentage point decrease.

The increase in our gross profit was primarily due to an increase in net sales of 18 percent. Our gross margin for fiscal 2008 was impacted negatively by a write down of \$448,000 for fabric that we determined would be unusable for future production. We determined that most of this fabric would likely be unusable in its current state because the remaining quantity after prior production runs was less than anticipated to make and design a cost effective garment to offer for sale. Excluding this adjustment, our gross margin would have increased over the prior year comparative period. Our gross margins for the second quarter of fiscal 2008 continued to be impacted positively by improvements in production schedules and shifting a greater percentage of our production requirements to a lower cost facility in Mexico from the United States.

### **Selling, General and Administrative Expense**

Selling, general and administrative, or SG&A, expenses decreased to \$5,968,000 for the second quarter of fiscal 2008 from \$6,605,000 for the second quarter of fiscal 2007, a 10 percent decrease.

The SG&A decrease in the second quarter of fiscal 2008 compared to the second quarter of fiscal 2007 is mostly due to a non-cash charge of \$1,483,000 in the second quarter of fiscal 2007 in connection with the settlement agreement with our former international distributor. The SG&A decrease represented by this non-cash charge was offset primarily by (i) an increase of \$443,000 in employee and employee-related expenses due to a higher headcount in the second quarter of fiscal 2008 compared to fiscal 2007 to support our growth and implementation of our strategic initiatives, including personnel to support our retail strategy; (ii) an increase of \$113,000 in sample expenses to support our development of a full collection of items; (iii) an increase of \$216,000 in stock-based compensation expense due to the issuance of restricted common stock and restricted stock units in the fourth quarter of fiscal 2007 and first quarter of fiscal 2008, respectively; and (iv) an increase of \$107,000 in facilities and distribution related expenses due to higher net sales.

### **Interest Expense**

Our combined interest expense decreased to \$167,000 for the second quarter of fiscal 2008 from \$202,000 for the second quarter of fiscal 2007, a 17 percent decrease. Our interest expense primarily consists of interest expense from our factoring and inventory lines of credit and letters of credit from CIT. The decrease in interest expense is mostly due to a lower average interest rate on our factoring and inventory lines of credit as compared to the prior year period.

### **Income Tax**

## Edgar Filing: JOE'S JEANS INC. - Form 10-Q

For the second quarter of fiscal 2008, our income tax expense was \$201,000 compared to \$5,000 for the second quarter of fiscal 2007. Our effective tax rate was nine percent for the second quarter of fiscal 2008 and one percent for the second quarter of fiscal 2007. We expect our effective tax rate to be approximately eight percent during fiscal 2008. For the three months ended May 31, 2008 and May 26, 2007, the difference between the effective tax rate and the statutory rate is primarily attributable to the utilization of net operation loss tax carryforwards against which a full valuation allowance has been established.

**Comparison of Six Months Ended May 31, 2008 to Six Months Ended May 26, 2007****Six Months Ended May 31, 2008 Overview**

The following table sets forth certain statements of operations data for the periods as indicated:

|                                   | Six months ended<br>(dollar values in thousands) |               |                 |               |
|-----------------------------------|--|---------------|-----------------|---------------|
|                                   | May 31, 2008                                     | May 26, 2007  | \$ Change       | % Change      |
| Net sales                         | \$ 33,165  | \$ 28,985     | \$ 4,180        | 14%           |
| Cost of goods sold                | 17,939   | 16,541        | 1,398           | 8%            |
| Gross profit                      | 15,226   | 12,444        | 2,782           | 22%           |
| Gross margin                      | 46%  | 43%           |                 |               |
| Selling, general & administrative | 11,572   | 11,587        | (15)            | (0)%          |
| Depreciation & amortization       | 174  | 175           | (1)             | (1)%          |
| Operating income                  | 3,480  | 682           | 2,798           | 410%          |
| Interest expense                  | (359)  | (395)         | 36              | (9)%          |
| Other expense                     |  | (25)          | 25              | (100)%        |
| Income before provision for taxes | 3,121  | 262           | 2,859           | 1,091%        |
| Income taxes                      | 263  | 13            | 250             | 1,923%        |
| <b>Net income</b>                 | <b>\$ 2,858</b>                                  | <b>\$ 249</b> | <b>\$ 2,609</b> | <b>1,048%</b> |

**Results of Operations**

For the six months ended May 31, 2008, our net sales increased to \$33,165,000 from \$28,985,000 for the six months ended May 26, 2007, a 14 percent increase. We generated net income of \$2,858,000 for the six months ended May 31, 2008 compared to \$249,000 for the six months ended May 26, 2007.

The primary reasons for the increase in net income for the six months ended May 31, 2008 compared to May 26, 2007 were the following:

- An increase of \$4,180,000, or 14 percent, in net sales coupled with a \$2,782,000, or 22 percent, improvement in gross profit;
- A three percentage point increase in gross margins; and
- Maintaining our selling, general and administrative expenses at a consistent level in spite of the increase in net sales.

**Net Sales**

Our net sales increased to \$33,165,000 for the six months ended May 31, 2008 compared to \$28,985,000 for the six months ended May 26, 2007, a 14 percent increase.

The increase can be attributed to continued brand acceptance for our Joe's Jeans® products in the marketplace by retailers and customers during the first six months of fiscal 2008. In an effort to increase our net sales during the first six months of fiscal 2008, we focused on expansion by increasing the number of department store doors carrying our products, increasing the average inventory per door, increasing the number of retailers participating in our replenishment program for our core basic styles offered continuously throughout the year, growing the retail and specialty stores that carry our men's and children's product lines and offering more products to our retailers and customers. We also experienced an increase in our European sales in the first six months of fiscal 2008 after we terminated our former international distributor in February 2007 and an increase in sales from our recently introduced men's and children's product lines.

### **Gross Profit**

Our gross profit increased to \$15,226,000 for the six months ended May 31, 2008 from \$12,444,000 for the six months ended May 26, 2007, a 22 percent increase. Our gross margin percentage increased to 46 percent for the six months ended May 31, 2008 from 43 percent for the six months ended May 26, 2007, a three percentage point increase.

The increase in our gross margin percentage was primarily due to our increase in net sales coupled with improvement in production schedules and shifting a greater percentage of our production requirements to a lower cost facility in Mexico from the United States in the first six months of fiscal 2008 compared to the first six months of fiscal 2007.

### **Selling, General and Administrative Expenses**

Selling, general and administrative, or SG&A, expenses decreased to \$11,572,000 for the six months ended May 31, 2008 from \$11,587,000 for the six months ended May 26, 2007, a less than one percent decrease.

The SG&A decrease in the six months ended May 31, 2008 compared to the six months ended May 26, 2007 is mostly due to a non-cash charge of \$1,483,000 in the six months ended May 26, 2007 in connection with the settlement agreement with our former international distributor. The SG&A decrease represented by this non-cash charge was offset primarily by (i) an increase of \$756,000 in employee and employee-related expenses due to a higher headcount to support our growth and implementation of our strategic initiatives, including personnel to support our retail strategy; (ii) an increase of \$330,000 in sample expenses to support our development of a full collection of items; and (iii) an increase of \$424,000 in stock-based compensation expense due to the issuance of restricted common stock and restricted stock units in the fourth quarter of fiscal 2007 and first quarter of fiscal 2008, respectively.

### **Interest Expense**

Our combined interest expense decreased to \$359,000 for the six months ended May 31, 2008 from \$395,000 for the six months ended May 26, 2007, a nine percent decrease. Our interest expense consists of interest expense from our factoring and inventory lines of credit and letters of credit from CIT. The decrease in interest expense is mostly due to a lower average interest rate on our factoring and inventory lines of credit as compared to the prior year period.





## Income Tax

For the six months ended May 31, 2008, our income tax expense was \$263,000 compared to \$13,000 for the six months ended May 26, 2007. Our effective tax rate was eight percent for the six months ended May 31, 2008 and one percent for the six months ended May 26, 2007. We expect our effective tax rate to be approximately eight percent during fiscal 2008. For the six months ended May 31, 2008 and May 26, 2007, the difference between the effective tax rate and the statutory rate is primarily attributable to the utilization of net operation loss tax carryforwards against which a full valuation allowance has been established.

## Liquidity and Capital Resources

Our primary sources of liquidity are: (i) cash from sales of our Joe's® products; and (ii) cash from sales of our accounts receivables and advances against inventory. For the six months ended May 31, 2008, we generated \$2,432,000 of cash flow from operations. Of this cash flow, we used \$701,000 to pay the earn-out payment under the merger agreement and \$120,000 for purchases of property and equipment. We repaid \$391,000 of our factor borrowings and our cash balance increased by \$1,220,000 to \$2,551,000 as of May 31, 2008.

We are dependent on credit arrangements with suppliers and factoring and inventory based agreements for working capital needs. From time to time, we have conducted equity financing through private placement transactions and obtained increases in our cash availability from CIT Commercial Services, Inc., a unit of CIT Group, or CIT, through guarantees by certain related parties.

During the second quarter of fiscal 2008, our primary methods to obtain the cash necessary for operating needs were through the sales of Joe's® products, sales of our accounts receivable pursuant to our factoring agreements and obtaining advances under our inventory security agreements with CIT. The accounts receivable are sold for up to 85 percent of the face amount on either a recourse or non-recourse basis depending on the creditworthiness of the customer. In addition, the agreements allow us to obtain advances for up to 50 percent of the value of certain eligible inventory. CIT currently permits us to sell our accounts receivable at the maximum level of 85 percent and allows advances of up to \$6,000,000 for eligible inventory. CIT has the ability, in its discretion at any time or from time to time, to adjust or revise any limits on the amount of loans or advances made to us pursuant to these agreements. As further assurance to CIT, cross guarantees were executed by and among us and all of our subsidiaries to guarantee each subsidiary's obligations. As of May 31, 2008, our cash availability with CIT was approximately \$323,000. This amount fluctuates on a daily basis based upon invoicing and collection related activity by CIT on our behalf. In connection with the agreements with CIT, most of our tangible assets are pledged to CIT, including all of our inventory, merchandise, and/or goods, including raw materials through finished goods and receivables. Our trademarks are not encumbered.

The agreements may be terminated by CIT upon 60 days' written notice or immediately upon the occurrence of an event of default, as defined in the agreement. The agreements may be terminated by us upon 60 days' written notice prior to June 30, 2010 or earlier provided that the minimum factoring fees have been paid for the respective period.

The factoring rate that we pay to CIT to factor accounts is at 0.6 percent for accounts which CIT bears the credit risk and 0.4 percent for accounts which we bear the credit risk and the interest rate associated with the agreements is at 0.25 percent plus the Chase prime rate.

Edgar Filing: JOE'S JEANS INC. - Form 10-Q

We have also established a letter of credit facility with CIT to allow us to open letters of credit for a fee of 0.25 percent of the letter of credit face value with international and domestic suppliers, subject to cash availability on our inventory line of credit.

As of May 31, 2008, we had \$7,221,000 of factored receivables with CIT and a loan balance of \$2,953,000 for inventory advances. We had 12 letters of credit in the aggregate amount of \$310,000 outstanding as of May 31, 2008.

For the remainder of fiscal 2008, our primary capital needs are for our operating expenses, including funds to support our retail strategy, which includes opening retail stores, and working capital necessary to fund inventory purchases, capital expenditures for our expected retail stores and finance extensions of our trade credit to our customers. We anticipate funding our operations through working capital generated by the following: (i) cash flow from sales of our products; (ii) reducing our inventory levels and managing our operating expenses; (iii) maximizing our trade payables with our domestic and international suppliers; (iv) increasing collection efforts on existing accounts receivables; and (v) utilizing our receivable and inventory-based agreements with CIT.

Based on our cash on hand, cash flow from operations and the expected cash availability under our agreements with CIT, we believe that we have the working capital resources necessary to meet our projected operational needs for the remainder of fiscal 2008. However, if we require more capital for growth or experience operating losses, we believe that it will be necessary to obtain additional working capital through credit arrangements or debt or equity financings. We believe that any additional capital, to the extent needed, may be obtained from additional sales of equity securities or other loans or credit arrangements. There can be no assurance that this or other financings will be available if needed. Our inability to fulfill any interim working capital requirements would force us to constrict our operations.

We believe that the rate of inflation over the past few years has not had a significant adverse impact on our net sales or income (losses) from operations.

#### *Off Balance Sheet Arrangements*

We do not have any off balance sheet arrangements.

#### **Management's Discussion of Critical Accounting Policies**

We believe that the accounting policies discussed below are important to an understanding of our financial statements because they require management to exercise judgment and estimate the effects of uncertain matters in the preparation and reporting of financial results. Accordingly, we caution that these policies and the judgments and estimates they involve are subject to revision and adjustment in the future. While they involve less judgment, management believes that the other accounting policies discussed in Notes to Consolidated Financial Statements - Note 2 Summary of Significant Accounting Policies included in our Annual Report are also important to an understanding of our financial statements. We believe that the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements.

#### *Revenue Recognition*

## Edgar Filing: JOE'S JEANS INC. - Form 10-Q

Revenues are recorded on the accrual basis of accounting when title transfers to the customer, which is typically at the shipping point. We record estimated reductions to revenue for customer programs, including co-op advertising, other advertising programs or allowances, based upon a percentage of sales. We also allow for returns based upon pre-approval or in the case of damaged goods. Such returns are estimated based on historical experience and an allowance is provided at the time of sale.

*Accounts Receivable and Due from Factor and Allowance for Customer Credits and Other Allowances*

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

The balance in the allowance for uncollectible accounts, customer credits and allowances as of May 31, 2008 and November 30, 2007 was \$597,000 and \$652,000 for non-factored accounts receivables.

*Inventory*

We continually evaluate the composition of our inventories, assessing slow-turning, ongoing product as well as product from prior seasons. Market value of distressed inventory is valued based on historical sales trends on our individual product lines, the impact of market trends and economic conditions, and the value of current orders relating to the future sales of this type of inventory. Significant changes in market values could cause us to record additional inventory markdowns.

*Valuation of Long-lived and Intangible Assets and Goodwill*

We assess the impairment of identifiable intangibles, long-lived assets and goodwill annually or whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors considered important that could trigger an impairment review other than on an annual basis include the following:

- A significant underperformance relative to expected historical or projected future operating results;
- A significant change in the manner of the use of the acquired asset or the strategy for the overall business; or
- A significant negative industry or economic trend.

When we determine that the carrying value of intangibles, long-lived assets and goodwill may not be recoverable based upon the existence of one or more of the above indicators of impairment, we will measure any impairment based on a projected discounted cash flow method using a discount rate determined by our management.

## Edgar Filing: JOE'S JEANS INC. - Form 10-Q

In fiscal 2007, we acquired through merger all of the intangible assets and goodwill related to the Joe s®, Joe s Jeans and JD® logo and marks. For fiscal 2007, we did not recognize any impairment related to the intangible assets and goodwill of our Joe s® brand since we acquired it in October 2007. We have assigned an indefinite life to these intangible assets and therefore, no amortization expenses are expected to be recognized. However, we will test the assets for impairment annually in accordance with our critical accounting policies.

*Additional Merger Consideration (Earn-out)*

In connection with the merger with JD Holdings, we agreed to pay to Mr. Dahan the following additional payments in the applicable fiscal year for 120 months following October 25, 2007:

- No earn out if the gross profit is less than \$11,250,000 in the applicable fiscal year;
- 11.33 percent of the gross profit above \$11,251,000 to \$22,500,000; plus
- an additional three percent of the gross profit from \$22,501,000 to \$31,500,000; plus
- an additional two percent of the gross profit from \$31,501,000 to \$40,500,000; plus
- an additional one percent of the gross profit above \$40,501,000.

The additional merger consideration, or earn-out, will be paid in advance on a monthly basis based upon estimates of gross profits after the assumption has been reached that the payments will likely be paid. At the end of each quarter, any overpayments will be offset against future payments and any significant underpayments will promptly be made.

EITF 95-8, *Accounting for Contingent Consideration Paid to the Shareholders of an Acquired Enterprise in a Purchase Business Combination*, addresses accounting for consideration transferred to settle a contingency based on earnings or other performance measures. It sets forth the criteria to determine whether contingent consideration based on earnings or other performance measures should be accounted for as (1) adjustment of the purchase price of the acquired enterprise or (2) compensation for services, use of property, or profit sharing.

The determination of how to account for the contingent consideration is a matter of judgment that depends on the relevant facts and circumstances. Based upon our evaluation of the relevant facts and circumstances, we have determined that accounting for the earn-out as additional purchase price is proper. Advanced earn-out payments are recorded as additional goodwill. For the six months ended May 31, 2008, we have recorded \$701,000 as additional goodwill.

*Income Taxes*

As part of the process of preparing our consolidated financial statements, management is required to estimate income taxes in each of the jurisdictions in which we operate. The process involves estimating actual current tax expense along with assessing temporary differences resulting from differing treatment of items for book and tax purposes. These timing differences result in deferred tax assets and liabilities, which are included in our consolidated balance sheet. Management records a valuation allowance to reduce its deferred tax assets to the amount that is more likely than not to be realized. Management has considered future taxable income and ongoing tax planning strategies in assessing the need for the valuation allowance. Increases in the valuation allowance result in additional expense to be reflected within the tax provision in the consolidated statement of income. Reserves are also estimated for ongoing audits regarding Federal and state issues that are currently unresolved. We routinely monitor the potential impact of these situations. Based on management's assessment, there has been no reduction of the valuation allowance other than to the extent current year net income was offset by net operating losses that carried forward.

*Contingencies*

We account for contingencies, other than income tax contingencies, in accordance with Statement of Financial Accounting Standards, or SFAS No. 5, Accounting for Contingencies . SFAS No. 5 requires that we record an estimated loss from a loss contingency when information available prior to issuance of our financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the financial statements and the amount of the loss can be reasonably estimated. Accounting for contingencies such as legal and income tax matters requires



management to use judgment. Many of these legal and tax contingencies can take years to be resolved. Generally, as the time period increases over which the uncertainties are resolved, the likelihood of changes to the estimate of the ultimate outcome increases. Management believes that the accruals for these matters are adequate. Should events or circumstances change, we could have to record additional accruals.

#### *Stock Based Compensation*

We adopted the provisions of and account for stock-based compensation in accordance with Statement of Financial Accounting Standards, or SFAS, 123(R), Share Based Payment on November 27, 2005. We elected the modified prospective method where prior periods are not revised for comparative purposes. Under the fair value recognition provisions of SFAS 123(R), stock based compensation is measured at grant date based upon the fair value of the award and expense is recognized on a straight-line basis over the vesting period. We use the Black-Scholes option pricing model to determine the fair value of stock options, which requires management to use estimates and assumptions, which are applied consistent with the prior year. If factors change or we employ different assumptions for estimating fair value of the stock option, our estimates may be different than future estimates or actual values realized upon the exercise, expiration, early termination or forfeiture of those awards in the future. At this time, we believe that our current method for accounting for stock based compensation is reasonable. Furthermore, under SFAS 123(R), an entity may elect either an accelerated recognition method or a straight-line recognition method for awards subject to graded vesting based on a service condition, regardless of how the fair value of the award is measured. For all stock based compensation awards that contain graded vesting based on service conditions, we have elected to apply a straight-line recognition method to account for these awards. See Notes to Condensed Consolidated Financial Statements Note 9 Stockholders Equity Stock Incentive Plans for additional discussion of SFAS 123(R).

#### *Recent Accounting Pronouncements*

On July 13, 2006, the FASB issued Interpretation No. 48, or FIN No. 48, Accounting for Uncertainty in Income Taxes: An interpretation of FASB Statement No. 109. This interpretation clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements in accordance with SFAS No. 109, Accounting for Income Taxes. FIN No. 48 prescribes a recognition threshold and measurement principles for financial statement disclosure of tax positions taken or expected to be taken on a tax return. This interpretation is effective for fiscal years beginning after December 15, 2006. We adopted FIN 48 effective December 1, 2007. The adoption of FIN No. 48 did not have a material impact on our results of operations, consolidated financial position or cash flows.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements, or SFAS No. 157, which defines fair value, establishes a framework for measuring fair value and requires enhanced disclosures about fair value measurements. SFAS No. 157 requires companies to disclose the fair value of their financial instruments according to a fair value hierarchy (i.e., levels 1, 2, and 3, as defined). Additionally, companies are required to provide enhanced disclosure regarding instruments in the level 3 category, including a reconciliation of the beginning and ending balances separately for each major category of assets and liabilities. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. We adopted SFAS No. 157 on December 1, 2007. Given the nature of our current financial instruments, the adoption of SFAS No. 157 did not have a material impact on our results of operations or consolidated financial position.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities - Including an Amendment of FASB Statement No. 115*, or SFAS No. 159. SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. Unrealized gains and losses on items for which the fair value option has been elected will be recognized in earnings at each subsequent reporting date. SFAS No. 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007. We adopted SFAS No. 159 on December 1, 2007. Given the nature of our current financial instruments, the adoption of SFAS No. 159 did not have a material impact on our results of operations or consolidated financial position.

On December 4, 2007, the FASB issued SFAS No. 141 (Revised 2007), *Business Combinations*, or SFAS No. 141(R). SFAS No. 141(R) will significantly change the accounting for business combinations. Under SFAS No. 141(R), an acquiring entity will be required to recognize all the assets acquired and liabilities assumed in a transaction at the acquisition-date fair value with limited exceptions. SFAS No. 141(R) also includes a substantial number of new disclosure requirements. SFAS No. 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008, which is the year beginning December 1, 2009 for us. We are currently evaluating the impact that SFAS No. 141(R) will have on our financial statements.

On December 4, 2007, the FASB issued SFAS No. 160, *Non-controlling Interests in Consolidated Financial Statements-an Amendment of Accounting Research Bulletin ( ARB ) No. 51*, or SFAS No. 160. SFAS No. 160 establishes new accounting and reporting standards for a non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. Specifically, this statement requires the recognition of a non-controlling interest (minority interest) as equity in the consolidated financial statements separate from the parent's equity. The amount of net income attributable to the non-controlling interest will be included in consolidated net income on the face of the income statement. SFAS No. 160 clarifies that changes in a parent's ownership interest in a subsidiary that do not result in deconsolidation are equity transactions if the parent retains its controlling financial interest. In addition, this statement requires that a parent recognize a gain or loss in net income when a subsidiary is deconsolidated. Such gain or loss will be measured using the fair value of the non-controlling equity investment on the deconsolidation date. SFAS No. 160 also includes expanded disclosure requirements regarding the interests of the parent and its non-controlling interest. SFAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008, which is the year beginning December 1, 2009 for us. We are currently evaluating the impact that SFAS No. 160 will have on our financial statements.

### **Item 3. Quantitative and Qualitative Disclosure About Market Risk.**

We are exposed to certain market risks arising from transactions in the normal course of our business. Such risk is principally associated with interest rate and changes in our credit standing.

#### **Interest Rate Risk**

Our obligations under our receivable and inventory agreements bear interest at floating rates (primarily JP Morgan Chase prime rate); therefore, we are sensitive to changes in prevailing interest rates. We believe that a one percent increase or decrease in market interest rates that affect our financial instruments would have an immaterial impact on earnings or cash flow during the next fiscal year.

#### **Foreign Currency Exchange Rates**

Edgar Filing: JOE'S JEANS INC. - Form 10-Q

Foreign currency exposures arise from transactions, including firm commitments and anticipated contracts, denominated in a currency other than an entity's functional currency and from foreign-denominated revenues translated into U.S. dollars.

We generally sell our products in U.S. dollars. However, we sell an immaterial amount of our products in Euros. Changes in currency exchange rates may affect the relative prices at which we and our foreign competitors sell products in the same market and collect receivables from such sales. We currently do not hedge our exposure to changes in foreign currency exchange rates. We cannot assure you that foreign currency fluctuations will not have a material adverse impact on our financial condition and results of operations.

We also source most of our products outside of the U.S. However, we generally purchase our products in U.S. dollars. The cost of these products may be affected by changes in the value of the relevant currencies; however, our exposure to currency exchange rates is limited as a result of such companies outside of the U.S. accepting payment in U.S. dollars.

#### **Item 4. Controls and Procedures.**

##### *Evaluation of Disclosure Controls and Procedures*

As of May 31, 2008, the end of the period covered by this periodic report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Securities Exchange Act Rule 15d-15.

Disclosure controls and procedures are controls and procedures that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Securities Exchange Act of 1934, or 1934 Act, is recorded, processed, summarized and reported within the time periods specified in the SEC rules and forms. Management recognizes that a control system, no matter how well conceived and operated, can provide only reasonable assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues within the company have been detected. Therefore, assessing the costs and benefits of such controls and procedures necessarily involves the exercise of judgment by management. Our disclosure controls and procedures are designed to provide reasonable assurance of achieving the objective of ensuring that information required to be disclosed in our reports filed or submitted under the 1934 Act is recorded, processed, summarized and reported within the time periods specified in the SEC rules and forms. In addition, our disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that the information required to be disclosed by us in the reports we file or submit under the 1934 Act is accumulated and communicated to management, including our principal executive and principal financial officers or persons performing similar functions, as appropriate, to allow timely decisions regarding required disclosure.

Our Chief Executive Officer and Chief Financial Officer have concluded, based on our evaluation of our disclosure controls and procedures, that our disclosure controls and procedures under Rule 13a-15(e) and Rule 15d-15(e) of the 1934 Act are effective at the reasonable assurance level.

##### *Changes in Internal Control Over Financial Reporting*

We made no changes in our internal control over financial reporting during the second quarter of the fiscal year covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.



**Item 4T. Controls and Procedures.**

Not Applicable.

**PART II OTHER INFORMATION**

**Item 1. Legal Proceedings.**

We are a party to lawsuits and other contingencies in the ordinary course of our business. We do not believe that it is probable that the outcome of any individual action would have an adverse effect in the aggregate on our financial condition. We do not believe that it is likely that an adverse outcome of individually insignificant actions in the aggregate would be sufficient enough, in number or in magnitude, to have a material adverse effect in the aggregate on our financial condition.

**Item 1A. Risk Factors.**

There have been no material changes from the risk factors previously disclosed in our Annual Report on Form 10-K for the fiscal year ended November 30, 2007.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

None.

**Item 3. Defaults upon Senior Securities.**

None.

**Item 4. Submission of Matters to a Vote of Security Holders.**

None.

**Item 5. Other Information.**

(a) None.

(b) There have been no material changes to the procedures by which security holders may recommend nominees to our board of directors, including adoption of procedures by which our stockholders may recommend nominees to the our board of directors.

**Item 6. Exhibits.**

Exhibits (listed according to the number assigned in the table in Item 601 of Regulation S-K):

| Exhibit No. | Description   | Document if Incorporated<br>by Reference         |
|-------------|---|--|
| 10.1        | Executive Employment Agreement by and between Joe's Jeans Inc. and Marc B. Crossman dated May 30, 2008  | Current Report on Form 8-K filed on June 5, 2008 |
| 31.1        | Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as amended   | Filed herewith                                   |
| 31.2        | Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as amended   | Filed herewith                                   |
| 32          | Certification of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 | Filed herewith                                   |



**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

July 15, 2008

**JOE S JEANS INC.**

/s/ Marc B. Crossman  
Marc B. Crossman  
Chief Executive Officer (Principal Executive Officer),  
President and Director

/s/ Hamish Sandhu  
Hamish Sandhu  
Chief Financial Officer (Principal Financial Officer and  
Principal Accounting Officer)

**EXHIBIT INDEX**

| <b>Exhibit No.</b> | <b>Description</b>  | <b>Document if Incorporated<br/>by Reference</b> |
|--------------------|---|--|
| 10.1               | Executive Employment Agreement by and between Joe's Jeans Inc. and Marc B. Crossman dated May 30, 2008  | Current Report on Form 8-K filed on June 5, 2008 |
| 31.1               | Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as amended   | Filed herewith                                   |
| 31.2               | Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as amended   | Filed herewith                                   |
| 32                 | Certification of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 | Filed herewith                                   |