INNOVO GROUP INC
Form 10-Q
October 05, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended August 26, 2006

OR

o 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

INNOVO GROUP INC.

(Exact name of registrant as specified in its charter)

Delaware	**11-2928178**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
5901 South Eastern Avenue, Commerce, California	**90040**
(Address of principal executive offices)	(Zip Code)

(323) 837-3700

(Registrant s telephone number, including area code)

5804 East Slauson Avenue, Commerce, California 90040

(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 to such filing requirements for the past 90 days.

x Yes o No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

(Check One):

Large accelerated filer o Accelerated filer x Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act).

Yes o No x

The number of shares of the registrant s common stock outstanding as of October 4, 2006 was 34,343,454.

INNOVO GROUP INC.

QUARTERLY REPORT ON FORM 10-Q

PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

INNOVO GROUP INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands)

	08/26/06 (unaudited)	**11/26/05**
ASSETS		
Current assets		
Cash and cash equivalents	$ 226	$ 560
Accounts receivable, net of allowance for customer credits and returns of $1,515 (2006) and $412 (2005)	793	60
Inventories, net	8,152	12,083
Due from related parties, net		2,781
Prepaid expenses and other current assets	382	96
Assets of discontinued operations	112	11,233
Total current assets	9,665	26,813
Property and equipment, net	855	428
Goodwill	20	20
Intangible assets, net	212	248
Other assets	134	87
Total assets	$ 10,886	$ 27,596
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities		
Accounts payable and accrued expenses	$ 5,607	$ 3,859
Due to factor		2,855
Due to related parties, net	1,777	54
Liabilities of discontinued operations	98	9,271
Total current liabilities	7,482	16,039
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: 80,000 shares authorized 34,455 shares issued and 34,343 outstanding (2006) and 33,414 shares issued and 33,302 outstanding (2005)	3,447	3,343
Additional paid-in capital	79,760	78,823
Accumulated deficit	(77,027)	(67,833)
Treasury stock, 112 shares	(2,776)	(2,776)
Total stockholders equity	3,404	11,557
Total liabilities and stockholders equity	$ 10,886	$ 27,596

The accompanying notes are an integral part of these financial statements

1

INNOVO GROUP INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

	Three months ended 08/26/06 (unaudited)	08/27/05	Nine months ended 08/26/06 (unaudited)	08/27/05
Net sales	$ 12,448	$ 12,600	$ 32,662	$ 28,424
Cost of goods sold	7,485	7,830	22,648	16,901
Gross profit	4,963	4,770	10,014	11,523
Operating expenses				
Selling, general and administrative	5,168	5,166	16,396	13,657
Depreciation and amortization	78	53	200	125
	5,246	5,219	16,596	13,782
Loss from continuing operations	(283)	(449)	(6,582)	(2,259)
Interest expense	(133)	(140)	(378)	(634)
Other income (expense)			(68)	7
Loss from continuing operations, before taxes	(416)	(589)	(7,028)	(2,886)
Income taxes	13	3	28	21
Loss from continuing operations	(429)	(592)	(7,056)	(2,907)
Income (loss) from discontinued operations, net of tax	(95)	2,007	(2,138)	4,209
Net income (loss)	$ (524)	$ 1,415	$ (9,194)	$ 1,302
Earnings (loss) per common share - Basic				
Earnings (loss) from continuing operations	$ (0.01)	$ (0.02)	$ (0.21)	$ (0.09)
Earnings (loss) from discontinued operations	0.00	0.06	(0.06)	0.13
Earnings (loss) per common share - Basic	$ (0.01)	$ 0.04	$ (0.27)	$ 0.04
Earnings (loss) per common share - Diluted				
Earnings (loss) from continuing operations	$ (0.01)	$ (0.02)	$ (0.21)	$ (0.09)
Earnings (loss) from discontinued operations	0.00	0.06	(0.06)	0.13
Earnings (loss) per common share - Diluted	$ (0.01)	$ 0.04	$ (0.27)	$ 0.04
Weighted average shares outstanding				
Basic	34,343	33,286	33,691	31,489
Diluted	34,343	33,286	33,691	31,489

The accompanying notes are an integral part of these financial statements

INNOVO GROUP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Nine months ended 08/26/06 (unaudited)	08/27/05
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash provided by (used in) continuing activities	$ 3,187	$ (2,976)
Cash provided by (used in) discontinued operations	574	(5)
Net cash provided by (used in) operating activities	3,761	(2,981)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property and equipment	(612)	(331)
Cash used in continuing activities	(612)	(331)
Cash provided by (used in) discontinued operations	614	(26)
Net cash provided by (used in) investing activities	2	(357)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from (payments on) factor borrowing, net	(2,855)	885
Payments on note payable officer		(439)
Proceeds from promissory note - former officer		703
Exercise of stock options		567
Exercise of warrants		2,284
Payment of stock issuance expense		(6)
Net cash (used in) provided by continuing activities	(2,855)	3,994
Cash used in discontinued operations	(1,242)	(201)
Net cash (used in) provided by financing activities	(4,097)	3,793
NET CHANGE IN CASH AND CASH EQUIVALENTS	(334)	455
CASH AND CASH EQUIVALENTS, at beginning of period	560	312
CASH AND CASH EQUIVALENTS, at end of period	$ 226	$ 767

The accompanying notes are an integral part of these financial statements

3

INNOVO GROUP INC AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY
(in thousands)

	Preferred Stock Shares	Preferred Stock Par Value	Common Stock Shares	Common Stock Par Value	Additional Paid-In Capital	Accumulated Deficit	Promissory Note - former Officer	Treasury Stock	Total Stockholders Equity
Balance, November 27, 2004	194	$	29,266	$ 2,927	$ 72,043	$ (51,400)	$ (703)	$ (2,588)	$ 20,279
Net loss						1,302			1,302
Payment of promissory note - former officer							703		703
Redemption of preferred stock	(194)								
Conversion of Convertible notes to common stock			2,560	256	4,129				4,385
Common stock registration related expense					(6)				(6)
Exercise of stock options			623	63	470			(188)	345
Exercise of warrants			965	97	2,187				2,284
Balance, August 27, 2005 (unaudited)		$	33,414	$ 3,343	$ 78,823	$ (50,098)	$	$ (2,776)	$ 29,292
Balance, November 26, 2005		$	33,414	$ 3,343	$ 78,823	$ (67,833)	$	$ (2,776)	$ 11,557
Net loss						(9,194)			(9,194)
Common stock issued to related party			1,041	104	(104)				
Stock-based compensation					1,041				1,041
Balance, August 26, 2006 (unaudited)		$	34,455	$ 3,447	$ 79,760	$ (77,027)	$	$ (2,776)	$ 3,404

The accompanying notes are an integral part of these financial statements

4

INNOVO GROUP INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - BASIS OF PRESENTATION

The unaudited condensed consolidated financial statements of Innovo Group, Inc., or Innovo Group, which include the accounts of its wholly-owned subsidiaries, for the three and nine months ended August 26, 2006 and August 27, 2005 and the related footnote information have been prepared on a basis consistent with Innovo Group s audited consolidated financial statements as of November 26, 2005 contained in Innovo Group s Annual Report on Form 10-K for the year ended November 26, 2005, or the Annual Report. Innovo Group s operating subsidiaries include the following entities: Joe s Jeans Inc., or Joe s, and Innovo Azteca Apparel, Inc., or IAA. All significant inter-company transactions have been eliminated. Currently, Innovo Group has only one segment of operations - apparel. Historically, Innovo Group operated in two segments - apparel and accessories.

As a result of the sale of assets related to certain areas of its operations, Innovo Group has reclassified and reported the following operating divisions of its various subsidiaries as Discontinued Operations : (1) its craft and accessories division operated under its Innovo Inc. subsidiary, or Innovo, sold in May 2005; (2) its former headquarters in Springfield, Tennessee that was used as a commercial rental property operated under its Leaseall Management Inc. subsidiary, or Leaseall, sold in February 2006; and (3) its private label apparel division operated by its IAA subsidiary and sold in May 2006. Continuing operations include the results of Innovo Group s branded apparel business, including certain terminated branded apparel lines, which were not separate operating divisions and thus, not considered to be part of Innovo Group s Discontinued Operations.

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 Innovo Group 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 Innovo Group s financial position, results of operations and cash flows for the interim periods presented. The results for the three and nine months ended August 26, 2006 are not necessarily indicative of the results anticipated for the entire year ending November 25, 2006.

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 INVENTORIES

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

	08/26/06	11/26/05
Finished goods	$ 4,904	$ 10,396
Work in progress	2,077	1,381
Raw materials	2,328	4,015
	9,309	15,792
Less allowance for obsolescence and slow moving items	(1,157)	(3,709)
	$ 8,152	$ 12,083

NOTE 3 SALE OF CERTAIN ASSETS OF PRIVATE LABEL APPAREL DIVISION

On March 31, 2006, Innovo Group and its IAA subsidiary entered into an Asset Purchase Agreement, or Cygne APA, with Cygne Designs, Inc., or Cygne. Pursuant to the Cygne APA, Innovo Group agreed to sell to Cygne certain assets related to its private label apparel division. These assets include the private label division s customer list, the assumption of certain existing purchase orders and inventory related to the private label division, and the assumption of the benefit of a non-compete clause in favor of Azteca Production International, Inc., or Azteca, entered into under the original asset purchase agreement between IAA and Azteca. In exchange for the purchased assets, Cygne agreed to assume certain liabilities associated with the private label division, including, the remaining obligation under the original promissory note executed in favor of Azteca under the original asset purchase agreement (and as more fully described in Note 4 Related Party Transactions), certain other liabilities owed in connection with the private label division to Azteca in excess of $1,500,000, certain liabilities associated with outstanding purchase orders and inventory schedules listed in the Cygne APA, the obligation to continue to pay the earn-out under the original asset purchase agreement and the assumption of the liabilities related to the workforce of the private label division. The aggregate value of the assumed liabilities which represented the purchase price for the transaction at the time of execution of the Cygne APA was estimated to be $10,437,000, subject to certain permitted adjustments on the closing date. On May 12, 2006, Innovo Group conducted its annual meeting of stockholders and its stockholders approved the sale of its private label apparel division pursuant to the Cygne APA. Immediately thereafter, Innovo Group and Cygne closed the transaction. No cash was transferred at closing and each party was responsible for its respective transaction costs. Innovo Group recorded an approximate charge of $36,000 for certain property and equipment disposed of or abandoned as part of discontinuing these operations.

The following table sets forth a summary of the assumption of the liabilities less the net book value of the assets and Innovo Group s resulting loss on the sale of these assets (in thousands):

Note payable - related party	$ 7,937
Other related party liabilities	2,500
Total purchase price (Liabilities assumed by buyer)	10,437
Net intangible asset - customer relationship	9,469
Raw material inventory	3,360
Loss on disposition of property and equipment	36
Net book value of assets sold	12,865
Loss, before transaction costs	2,428
Transaction costs	186
Loss on sale of Private Label Apparel Division	$ 2,614

NOTE 4 RELATED PARTY TRANSACTIONS

As of August 26, 2006 and November 26, 2005, Innovo Group s related party balance consisted of amounts due (to) or due from certain related parties, as further described below, as follows:

	(in thousands) 8/26/2006	11/26/05
Commerce Investment Group and affiliates	$ (1,594)	$ 2,781
JD Design	(183)	(54)
Due (to) from related parties, net	$ (1,777)	$ 2,727

Commerce Investment Group and affiliates

Innovo Group has a strategic relationship with certain of its stockholders, Hubert Guez, Paul Guez and their affiliated companies, including Azteca and Commerce Investment Group LLC, or Commerce. By virtue of this relationship, Innovo Group has entered into the following agreements, at various times, with Hubert Guez, Paul Guez and their affiliated companies, Azteca and/or Commerce, entities in which Hubert Guez and Paul Guez have controlling interests.

The following table represents charges from the affiliated companies pursuant to Innovo Group s relationship with them, including its discontinued operations, as follows:

	Three months ended (in thousands)		Nine months ended (in thousands)	
	8/26/06	8/27/05	8/26/06	8/27/05
Continuing operations				
Purchase order arrangements	$ 6,661	$ 795	$ 8,611	$ 1,919
Verbal facilities arrangement	28	109	255	242
Discontinued operations				
Supply agreement / Purchase order arrangements	208	19,929	16,850	50,739
Earn-out due to Sweet Sportswear	4	436	248	1,120
Verbal facilities agreement		181	302	543
Principal and interest on note payable		273	1,087	518
Supply and Distribution agreement				639

Continuing Operations - Purchase order arrangement

Due to a preexisting relationship with AZT International SA de CV, a Mexican corporation and wholly owned subsidiary of Azteca, or AZT, as a supplier of finished goods for its discontinued private label operations, Innovo Group utilizes AZT as a supplier on a purchase order basis for certain of its Joe s Jeans® denim products. Under this arrangement, Innovo Group advances the funds to purchase raw materials, which primarily includes fabric, anticipated for production of its products. Innovo Group pays AZT for the production cost less credit for the advances on raw materials. Innovo Group purchases these products in various stages of production from partial to completed finished goods.

Continuing Operations - Verbal facilities arrangement

Until mid-July 2006, Innovo Group utilized space for its headquarters and principal executive offices under a verbal month-to-month arrangement with Azteca. Under this arrangement, Innovo Group paid to Azteca a monthly fee for allocated expenses associated with its use of office and warehouse space, including a fee charged on a per unit basis for inventory, and expenses in connection with maintaining such office and warehouse space. These allocated expenses included, but were not limited to, rent, security, office supplies, machine leases and utilities. In mid-July 2006, Innovo Group moved its headquarters and principal executive offices to nearby office and warehouse space at 5901 Eastern Avenue, Commerce, California and accordingly, no longer has any obligation to pay Azteca under the verbal facilities arrangement.

Discontinued Operations Supply Agreement

In July 2003, under an asset purchase agreement, or Blue Concept APA, with Azteca, Hubert Guez and Paul Guez, Innovo Group s IAA subsidiary acquired the Blue Concept Division of Azteca, a division which sells denim apparel primarily to American Eagle Outfitters, Inc., or AEO. Simultaneous with the Blue Concept APA, IAA entered into a non-exclusive Supply Agreement with AZT for the purchase of denim products to be sold to AEO, which expired on July 17, 2005. Under the terms of the Supply Agreement, AZT agreed that the purchase price on the products supplied would provide for a margin per unit of 15%. After the expiration of the supply agreement, Innovo Group continued to utilize AZT as a supplier on a purchase order basis for its AEO products under similar terms. Upon completion of the sale of IAA s private label division to Cygne, as discussed in Note 3 above, Cygne assumed $2,500,000 of the amount owed to AZT under this purchase order supply arrangement.

Discontinued Operations - Earn-out due to Sweet Sportswear LLC

The Blue Concept APA also provided for the calculation and payment, on a quarterly basis, to Sweet Sportswear LLC, an entity owned by Hubert and Paul Guez, of an amount equal to 2.5% of the gross sales solely attributable to AEO. Under the terms of the Cygne APA, Cygne assumed the future liability associated with this payment.

Discontinued Operations - Principal and interest on note payable

Innovo Group had originally incurred long-term debt in connection with the purchase of the Blue Concept Division from Azteca. In July 2003, IAA issued a seven-year unsecured, convertible promissory note in the principal amount of $21.8 million, or the Blue Concept Note. The Blue Concept Note bore interest at a rate of 6% and required payment of interest only during the first 24 months and then was fully amortized over the remaining five-year period. On March 5, 2004, after stockholder approval, a portion of the Blue Concept Note was converted into 3,125,000 shares of common stock at a value per share of $4.00. Under the terms of the Cygne APA, Cygne assumed the remaining principal balance of the Blue

Concept Note. On May 12, 2006, pursuant to the closing of the transaction, Azteca released Innovo Group from any and all remaining obligations under the Blue Concept Note and the Blue Concept Note has been reclassified as a discontinued operation liability. Under the terms of the original asset purchase agreement, in addition to the shares previously issued, Innovo Group issued on May 17, 2006 an additional 1,041,667 shares of its common stock as a result of its average stock price trading at less than $3.00 per share for the period between February 10, 2006 and March 12, 2006. This share issuance has been recognized in the Statement of Stockholders Equity.

Discontinued Operations - Craft and accessories business segment

In August 2000, Innovo Group entered into a supply agreement and a distribution agreement for its craft products with Commerce. In connection with the sale of the craft inventory and certain other assets of its Innovo subsidiary in May 2005, both the supply agreement and the distribution agreement were terminated.

Aggregate balances by entities

As of August 26, 2006 and November 26, 2005, respectively, the balances due (to) or due from these related parties and certain of their affiliates are as follows:

	(in thousands) **8/26/2006**	**11/26/05**
AZT International SA de CV	$ (1,940)	$ 56
AZT International SA de CV - Raw Material Advances	3,922	
Commerce Investment Group	(3,598)	5,667
Sweet Sportswear, LLC	(4)	(3,079)
Owenslab Jean, LLC		61
Team Pro International		19
Blue Concepts, LLC/Yanuk		57
Cygne Design	26	
	$ (1,594)	$ 2,781

The AZT balances represent the balances due as a result of Innovo Group s current production efforts in Mexico for our branded label apparel production. Upon completion of the sale of IAA s private label division to Cygne, as discussed in Note 3 above, Cygne assumed the aggregate liability in the amount of $2,500,000 owed to Commerce and its affiliates. The balance due to Commerce represents the adjusted balance remaining that Innovo Group continues to be obligated for after the completion of the transaction with Cygne. The balance of $26,000 due from Cygne represents the amount Innovo Group is owned by Cygne for various reimbursable expenses related to the transition of the private label division.

Joe s Jeans License

On February 7, 2001, Innovo Group acquired a license for the rights to the Joe s Jeans label from JD Design, LLC, or JD Design, along with the right to market the previously designed product line and existing sales orders, in exchange for 500,000 shares of Innovo Group s common stock and a warrant contingent on certain sales and gross margins which were not met and therefore, not eligible for exercise.

Additionally, Joe Dahan, the designer of the Joe s Jeans line and managing member of JD Design, joined Innovo Group as President of its wholly owned subsidiary, Joe s Jeans, Inc. Under his employment agreement, Mr. Dahan received an option, with a four-year term, to purchase 250,008 shares of Innovo Group s common stock at $1.00 per share, vesting over 24 months. This option was exercised in full as of January 26, 2005. Under the terms of the license, Innovo Group is required to pay a royalty of 3% on net sales of its licensed products to JD Design. In October 2005, Innovo Group granted JD Design the right to develop the children s branded apparel line under an amendment to its master license agreement in exchange for a 5% royalty on net sales of those products. In addition, Innovo Group had a verbal arrangement to pay JD Design a design fee of 3% of net sales for assistance related to designs for its indie products, the line of business that Innovo Group exited in early 2006.

For the three and nine months ended August 26, 2006 and August 27, 2005, the following table sets forth royalties, fees and income related to JD Design.

	Three months ended (in thousands)		**Nine months ended (in thousands)**	
	8/26/06	**8/27/05**	**8/26/06**	**8/27/05**
Expense (income):				
Joe s Jeans royalty expense	$ 372	$ 367	$ 935	$ 791
indie Design Fee	2	7	40	25
Children s license, royalty income	(14)		(40)	

NOTE 5 LOSS FROM DISCONTINUED OPERATIONS

During fiscal 2004, Innovo Group made the decision to market for sale its commercial rental property consisting of four separate buildings that served as its former headquarters located in Springfield, Tennessee and to offer for sale the assets of its craft and accessory segment of operations conducted through its Innovo subsidiary. On May 17, 2005, Innovo Group completed the sale of the assets of its craft and accessory segment of operations. In February 2006, Innovo Group completed the sale of each of the four separate buildings that served as its former headquarters for an aggregate sales price of $741,000 before net selling costs of approximately $126,000. Innovo Group also paid off the remaining note payable balance of $287,000 collateralized by a first deed of trust on these buildings with the proceeds from the sale. In connection with the sale of one of the buildings, Innovo Group received a promissory note issued by the purchaser in the original principal amount of $50,000, which represented a portion of the purchase price. As of August 26, 2006, $2,000 of the promissory note has been included on Innovo Group s balance sheet under Other current assets and $47,000 of the promissory note has been included under non-current Other assets of continuing operations. The note bears interest at a rate of 8%, has a term of five years and is collateralized by a deed of trust on the building.

In accordance with the provisions of SFAS No. 144 Accounting for the Impairment or Disposal of Long-Lived Assets, the accompanying unaudited condensed consolidated financial statements reflect the results of operations and financial position of Innovo Group s commercial rental property, its craft and accessory business segment and its private label apparel division separately as discontinued operations.

The assets and liabilities of the discontinued operations are presented in the unaudited condensed consolidated balance sheet under the captions Assets of Discontinued Operations and Liabilities of Discontinued Operations. The underlying assets and liabilities of the discontinued operations are as follows:

	(in thousands) Innovo, Inc.	Leaseall Management	Private Label Business	Total
August 26, 2006				
Cash and cash equivalents			$ 19	$ 19
Accounts receivable and due from factor, net of allowance for customer credits and allowances of $0 (2006)			70	70
Inventories			23	23
Assets of discontinued operations			$ 112	$ 112
Accounts payable and accrued expenses			$ 98	$ 98
Liabilities of discontinued operations			$ 98	$ 98
November 26, 2005				
Cash and cash equivalents	$ 5		$ 68	$ 73
Accounts receivable and due from factor, net of allowance for customer credits and allowances of $23 (2005)		16	8	24
Inventories			366	366
Prepaid expenses and other current assets		18	20	38
Property, Plant and Equipment, net		599	59	658
Intangible assets, net			10,074	10,074
Assets of discontinued operations	$ 5	$ 633	$ 10,595	$ 11,233
Accounts payable and accrued expenses		$ 5	$ 87	$ 92
Due to factor			$ 130	130
Note payable		$ 287		287
Note payable - related party			8,762	8,762
Liabilities of discontinued operations		$ 292	$ 8,979	$ 9,271

The following table sets forth the loss from the discontinued operations of each period.

(in thousands)	Innovo, Inc.	Leaseall Management	Private Label Business	Total
Three months ended August 26, 2006				
Net sales	$	$	$ 482	$ 482
Pre-tax loss from operations			(14)	(14)
Loss on sale of assets			(81)	(81)
Income tax				
Discontinued operations, net of tax	$	$	$ (95)	$ (95)
Three months ended August 27, 2005				
Net sales	$	$	$ 23,752	$ 23,752
Pre-tax income (loss) from operations	(45)	(16)	2,070	2,009
Gain on sale of assets				
Income tax	1	1		2
Discontinued operations, net of tax	$ (46)	$ (17)	$ 2,070	$ 2,007
Nine months ended August 26, 2006				
Net sales	$	$	$ 20,483	$ 20,483
Pre-tax income (loss) from operations	(4)	(34)	498	460
Gain (loss) on sale of assets		16	(2,614)	(2,598)
Income tax				
Discontinued operations, net of tax	$ (4)	$ (18)	$ (2,116)	$ (2,138)
Nine months ended August 27, 2005				
Net sales	$ 2,490	$	$ 60,424	$ 62,914
Pre-tax income (loss) from operations	(263)	(96)	4,192	3,833
Gain on sale of assets	377			377
Income tax	1			1
Discontinued operations, net of tax	$ 113	$ (96)	$ 4,192	$ 4,209

Pre-tax income (loss) from discontinued operations does not include an allocation of corporate overhead costs.

NOTE 6 ACCOUNTS RECEIVABLE, FACTOR FINANCING AND DUE (TO) FACTOR

Accounts receivable and due to factor consist of the following (in thousands):

	Continuing operations		Discontinued operations	
	08/26/06	11/26/05	08/26/06	11/26/05
Non-recourse receivables	$ 6,747	$ 3,435	$ 147	$ 3,654
Client recourse receivables	2,345	1,989	84	70
Total receivables assigned to factor	9,092	5,424	231	3,724
Allowance for customer credits and doubtful accounts	(907)	(796)		(67)
Net loan balance from factor	(7,656)	(7,483)	(161)	(3,787)
Due from (to) factor	$ 529	$ (2,855)	$ 70	$ (130)
Non-factored accounts receivable	872	472		47
Allowance for customer credits and doubtful accounts	(608)	(412)		(23)
Accounts receivable, net of allowance	$ 793	$ 60	$ 70	$ 24

Innovo Group bears the risk of payment in the event of non-payment by the customers for the client recourse receivables sold to factor for both continuing and discontinued operations. Innovo Group records its accounts receivable on the balance sheet net of receivables factored with CIT. Further, in the event its loan balance with CIT exceeds the face value of the receivables factored, net of allowances, with CIT, Innovo Group records the difference as a liability on its balance sheet as Due to Factor.

CIT Commercial Services

On June 1, 2001, Innovo Group s Innovo and Joe s subsidiaries, and on September 10, 2001, its IAA subsidiary, entered into accounts receivable factoring agreements with CIT. Subsequent to these agreements, the subsidiaries also entered into inventory security agreements, collectively with the factoring agreements referred to as the Factoring Facilities. These Factoring Facilities give Innovo Group, through its operating subsidiaries, the ability to obtain cash in advance from the sale of certain of its account receivables for up to 85% of the face amount of the factored receivables, on either a recourse or non-recourse basis depending on the creditworthiness of the customer, and also allow Innovo Group to obtain advances for up to 50% of the value of certain 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 cash available or advances made to us pursuant to the Factoring Facilities. As further assurance to enter into the Factoring Facilities, cross guarantees were executed by and among Innovo Group, Innovo, Joe s and IAA, to guarantee each subsidiaries obligations and in November 2004, upon request by CIT, Innovo Group s Chairman, Sam Furrow, executed a personal guarantee for up to $1,000,000. During fiscal 2006, this personal guarantee by Mr. Furrow allowed Innovo Group to obtain advances under the existing Factoring Facilities.

Presently, Innovo Group obtains funds under the Factoring Facilities at 85% of factored invoices and under the inventory security agreement of up to $1,000,000 of maximum availability. As of August 26, 2006, Innovo Group s availability with CIT was approximately $341,000 under the Factoring Facilities. 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. With the sale and cessation of operations for certain divisions and business lines, Innovo Group is primarily utilizing the Factoring Facilities of its Joe s Jeans subsidiary; however, certain of its other subsidiary Factoring Facilities have limited activity.

These Factoring Facilities may be terminated by CIT upon 60 days prior written notice or immediately upon the occurrence of an event of default, as defined in the agreement. The agreements may be terminated by Innovo Group or its subsidiaries, upon 60 days advanced written notice prior to June 30, 2007 or earlier provided that the minimum factoring fees have been paid for the respective period.

The factoring rate that Innovo Group pays to CIT to factor accounts is at 0.6% for accounts which CIT bears the credit risk and 0.4% for accounts which Innovo Group bears the credit risk and the interest rate associated with borrowings under the inventory lines and factoring facility is at 0.25% plus the Chase prime rate. As of August 26, 2006, the Chase prime rate was 8.25%.

In addition, in the event Innovo Group needs additional funds, Innovo Group has also established a letter of credit facility with CIT to allow it to open letters of credit for a fee of 0.25% of the letter of credit face value with international and domestic suppliers, subject to availability under the Factoring Facilities.

As of August 26, 2006, Innovo Group had $8,416,000 of factored accounts receivable, net of allowances, with CIT and a loan balance of $7,817,000, including a discontinued operations balance. Innovo Group had seven open letters of credit outstanding in the aggregate amount of $220,000 as of August 26, 2006.

NOTE 7 EARNINGS PER SHARE

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

	Three months ended (in thousands, except per share data) 08/26/06	08/27/05	Nine months ended (in thousands, except per share data) 08/26/06	08/27/05
Basic Earnings (Loss) per share Computation:				
Numerator				
Loss from continuing operations	$ (429)	$ (592)	$ (7,056)	$ (2,907)
Income (loss) from discontinued operations	(95)	2,007	(2,138)	4,209
Net income (loss)	$ (524)	$ 1,415	$ (9,194)	$ 1,302
Denominator:				
Weighted average common shares outstanding	34,343	33,286	33,691	31,489
Earnings (Loss) per Common Share - Basic				
Loss from continuing operations	$ (0.01)	$ (0.02)	$ (0.21)	$ (0.09)
Income (loss) from discontinued operations	(0.00)	0.06	(0.06)	0.13
Net income (loss)	$ (0.01)	$ 0.04	$ (0.27)	$ 0.04
Diluted Earnings (Loss) per share Computation:				
Numerator				
Loss from continuing operations	$ (429)	$ (592)	$ (7,056)	$ (2,907)
Income (loss) from discontinued operations	(95)	2,007	(2,138)	4,209
Net income (loss)	$ (524)	$ 1,415	$ (9,194)	$ 1,302