BLUE HOLDINGS, INC.
Form 10KSB
April 02, 2007

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

FORM 10-KSB

x Annual Report Under Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended December 31, 2006

o Transition Report Under Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission file number 000-33297

BLUE HOLDINGS, INC.
(Name of Small Business Issuer in its Charter)

Nevada	**88-0450923**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

5804 East Slauson Avenue
Commerce, California 90040
(Address of Principal Executive Offices and Zip Code)

(323) 725-5555
(Issuer's Telephone Number)

Securities Registered Under Section 12(b) of the Exchange Act:

None

Securities Registered Under Section 12(g) of the Exchange Act:

Common Stock, $0.001 par value
(Title of Class)

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

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. o

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

The issuer's revenues for the fiscal year ended December 31, 2006 were $48,996,375.

At March 26, 2007, the aggregate market value of the voting stock held by non-affiliates of the issuer was approximately $8,739,700.

At March 26, 2007, the issuer had 26,057,200 shares of Common Stock, $0.001 par value, issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's Proxy Statement to be filed with the Securities and Exchange Commission are incorporated by reference into Part III, Items 9, 10, 11, 12 and 14 of this Form 10-KSB.

Transitional Small Business Disclosure Format (check one): Yes o No x

BLUE HOLDINGS, INC.
2006 FORM 10-KSB ANNUAL REPORT

TABLE OF CONTENTS

PART I

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This 2006 Annual Report on Form 10-KSB, including the sections entitled “Risk Factors,” “Management’s Discussion and Analysis of Financial Condition and Results of Operation” and “Business,” contains “forward-looking statements” that include information relating to future events, future financial performance, strategies, expectations, competitive environment, regulation and availability of resources. These forward-looking statements include, without limitation, statements regarding projections, predictions, expectations, estimates or forecasts for our business, financial and operating results and future economic performance, statements of management’s goals and objectives; and other similar expressions concerning matters that are not historical facts. Words such as “may,” “will,” “should,” “could,” “woul “predicts,” “potential,” “continue,” “expects,” “anticipates,” “future,” “intends,” “plans,” “believes” and “estimates, expressions, as well as statements in future tense, identify forward-looking statements.

Forward-looking statements should not be read as a guarantee of future performance or results, and will not necessarily be accurate indications of the times at, or by which, that performance or those results will be achieved. Forward-looking statements are based on information available at the time they are made and/or management’s good faith belief as of that time with respect to future events, and are subject to risks and uncertainties that could cause actual performance or results to differ materially from those expressed in or suggested by the forward-looking statements. Important factors that could cause these differences include, but are not limited to our failure to implement our business plan within the time period we originally planned to accomplish and other factors discussed under the headings “Risk Factors,” “Management’s Discussion and Analysis or Plan of Operation” and “Business.”

Forward-looking statements speak only as of the date they are made. You should not put undue reliance on any forward-looking statements. We assume no obligation to update forward-looking statements to reflect actual results, changes in assumptions or changes in other factors affecting forward-looking information, except to the extent required by applicable securities laws. If we do update one or more forward-looking statements, no inference should be drawn that we will make additional updates with respect to those or other forward-looking statements.

All references to “we,” “our,” “us” and the “Company” in this Annual Report on Form 10-KSB refer to Blue Holdings, Inc and its subsidiaries.

ITEM 1. Description of Business

Overview

We design, manufacture and market high-end fashion jeans, apparel and accessories under the principal brand names *Antik Denim*, *Taverniti So Jeans, Yanuk* and *Faith Connexion.* We are also party to a joint venture that operates the brand *Life & Death*, and are currently looking into integrating *Life & Death* as one of our brands. On occasion, we produce apparel under private labels. Our products include jeans, jackets, belts, purses and T-shirts. We sell premium denim products and accessories in high-end department stores and fashion boutiques that cater to fashion conscious consumers. Our products are currently sold in the United States, Canada, Japan and the European Union directly to department stores and boutiques, including Bloomingdales, Nordstrom, Macy’s, Saks and Fred Segal, and through distribution arrangements in a number of countries abroad.

We operate in the high-end fashion denim industry. Our current competitors are companies that market such brands as Joe’s Jeans, True Religion, Seven For All Mankind and Citizens of Humanity. Our goal is to build a broad and diversified portfolio of brands selling premium denim apparel and accessories across a range of retail price points through wholesale and retail distribution channels.

1

We also sell directly to consumers at retail prices, which are higher than wholesale prices, and we expect to increase gross margins and profitability as we gradually increase the number of our retail stores. We will also be able to test new brands and product concepts in a cost-effective way prior to full launch.

Corporate Background

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

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

On April 14, 2005, we entered into an Exchange Agreement (the "Antik Exchange Agreement") with Antik Denim, LLC, a California limited liability company formed in September 2004 ("Antik"), the members of Antik (the "Antik Members"), and KRM Fund. The closing of the transactions contemplated by the Antik Exchange Agreement occurred on April 29, 2005. At the closing, we acquired all of the outstanding membership interests of Antik (the "Antik Interests") from the Antik Members, and the Antik Members contributed all of their Antik Interests to us. In exchange, we issued to the Antik Members 843,027 shares of our Series A Convertible Preferred Stock, par value $0.001 per share (the "Preferred Shares"), which, as a result of the approval by a substantial majority of our outstanding shareholders entitled to vote and the approval by our Board of Directors, of amendments to our Articles of Incorporation that (i) changed our name to Blue Holdings, Inc., (ii) increased our authorized number of shares of common stock to 75,000,000, and (iii) adopted a 1-for-29 reverse stock split, on June 7, 2005 converted into 24,447,783 shares of our common stock on a post-reverse stock split basis.

At the closing, Antik became our wholly-owned subsidiary. The exchange transaction with Antik was accounted for as a reverse merger (recapitalization) with Antik deemed to be the accounting acquirer, and we were deemed to be the legal acquirer.

On October 31, 2005, we entered into an Exchange Agreement (the "Taverniti Exchange Agreement") with Taverniti So Jeans, LLC, a California limited liability company formed in September 2004 ("Taverniti"), and the members of Taverniti (the "Taverniti Members"). Under the Taverniti Exchange Agreement, we acquired all of the outstanding membership interests of Taverniti (the "Taverniti Interests") from the Taverniti Members, and the Taverniti Members contributed all of their Taverniti Interests to us. In exchange, we issued to the Taverniti Members, on a pro rata basis, an aggregate of 500,000 shares of our Common Stock, par value $0.001 per share, and paid to the Taverniti Members, on a pro rata basis, an aggregate of Seven Hundred Fifty Thousand Dollars ($750,000). At the closing of the exchange transaction, Taverniti became our wholly-owned subsidiary.

Significant Developments

On March 31, 2006, we entered into a Letter of Intent with Global Fashion Group, SA ("Global Fashion Group") to form a new joint venture company which would have a license to produce, manufacture and distribute apparel and accessories for our three principal brands, *Antik Denim*, *Taverniti So Jeans* and *Yanuk*, throughout Europe and other territories. The initial term of the license was for two years, with automatic renewal for an additional three-year term if the joint venture achieved target net sales and was not in breach of the license. Under the terms of the Letter of Intent, the joint venture would pay to us a royalty of fifteen percent (15%) of all net sales of the licensed products and would pay guaranteed minimum royalties on an annual basis in the aggregate amount of $17.7 million through 2010 assuming the license to the joint venture was renewed. The Letter of Intent provided for an upfront initial license fee of $241,820. The joint venture would have a right of first refusal to license future brands developed by us and neither the joint venture nor Global Fashion Group would be permitted to engage in competitive activities with respect to the products licensed to the joint venture during the term of the license. On October 5, 2006, we agreed to terminate the Letter of Intent previously entered into with Global Fashion Group because we were unable to come to an agreement with Global Fashion Group on the final terms of the license to be held by the joint venture company contemplated under the Letter of Intent.

On June 19, 2006, we entered into an Agreement and Plan of Merger (the "Merger Agreement") with LR Acquisition Corporation, a District of Columbia corporation and our wholly-owned subsidiary ("LR Acquisition"), Long Rap, Inc., a District of Columbia corporation ("Long Rap"), the stockholders of Long Rap and Charles Rendelman, as the Long Rap stockholders' representative, pursuant to which LR Acquisition would merge (the "Merger") with and into Long Rap with Long Rap surviving the Merger as our wholly-owned subsidiary. Each holder of an outstanding share of the common stock of Long Rap would receive, as merger consideration, (1) an amount of cash equal to $16,000,000 divided by the outstanding shares of the common stock of Long Rap on a fully-diluted basis, and (2) that number of shares obtained by dividing (A) $16,000,000 divided by the closing price of a share of our common stock, as quoted on the NASDAQ Capital Market, over the ten trading days immediately preceding the effective time of the merger by (B) the number of shares of the common stock of Long Rap on a fully-diluted basis. On October 10, 2006, we mutually agreed with Long Rap to terminate the Merger Agreement. We determined, along with Long Rap, that it would not be in the best interests of our respective stockholders to proceed with the Merger.

On September 15, 2006, we entered into a Joint Venture Agreement Term Sheet with Philippe Naouri and Alexandre Caugant, the members of Life & Death, LLC ("L&D"), pursuant to which we acquired 50% of the membership interests of L&D. L&D owns the *Life & Death* trademark application and designs, develops, manufactures and distributes knit apparel under the brand *Life & Death*. We share 50% in the profits and losses of L&D based on our membership interest in L&D. Alexandre Caugant and Philippe Naouri are the principal designers of *Life & Death* and are also our employees.

On December 4, 2006, Antik entered into a binding Licensing Term Sheet with North Star International, Inc. ("North Star"), pursuant to which the parties agreed to enter into a Licensing Agreement whereby North Star, or its designee, will obtain a license to distribute Antik's knit apparel and hats in all categories for men and women bearing the *Antik Denim* trademark in the United States and internationally. The license will have a term of 66 months commencing on October 1, 2006, and will be subject to five renewal options for one-year terms. Pursuant to the terms of the Licensing Term Sheet, upon execution of the Licensing Term Sheet North Star paid Antik a fee of $180,000 as an advance against royalties. North Star will also pay Antik royalties of 4.5% of net sales up to $4 million, and 10% of net sales thereafter, during the first 18 months of the term, and 10% of all net sales thereafter. North Star has also guaranteed certain minimum net sales during the term of the license. For each renewal term, the minimum net sales guaranty will increase by 10% over the previous year's minimum net sales guaranty. The Licensing Term Sheet also provides that disputes involving the license shall be settled by binding arbitration.

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

In March 2007, the United States Internal Revenue Service initiated an examination of our Federal income tax return for the year ended December 31, 2005. Due to very initial stage of audit, we cannot currently anticipate any potential adjustments that may need to be reflected in the consolidated financial statements included in this Annual Report on Form 10-KSB.

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

Business Strategy

We strive to build on our position in the principal markets in which we compete by focusing on the following three core elements of our business strategy.

Product Strategy

Our overall product strategy is to offer multiple brands of apparel in the premium and better denim segments. As a result of license agreements with Yanuk Jeans, LLC, a company owned by Paul Guez, and Faith, and the acquisition of Antik and Taverniti So Jeans LLC, we currently market our products under the *Antik Denim*, *Taverniti So Jeans*, *Yanuk, Faith Connexion* and *U* brands and plan to continue to further expand our brand portfolio by acquisition and/or license of existing apparel companies and/or brands, as applicable, in the premium or better segments of the industry, or the creation of new brands by our internal design team. Although no definitive arrangement or plan is currently in place, we expect our management to periodically review potential acquisition and licensing opportunities to expand our product line and brands in these targeted market segments. In connection with this strategy we are looking into integrating *Life & Death* as one of our brands. Our goal is to employ a multi-brand strategy to reduce risks associated with the natural life cycle of a single brand and to appeal to a broader customer base with different looks from different brands. We believe the increase in demand for premium denim products over the last couple of years and relatively high retail price points for premium jeans, ranging from approximately $150 to $400, offers us a significant opportunity to increase our revenues and improve our profitability.

We also intend to license our proprietary owned and licensed trademarks with respect to products that we believe are not in our core line of business. While there is no existing plan with respect to the types of products to which we intend to license our proprietary trademarks, on September 8, 2005, Antik entered into a license agreement with Titan Industries, Inc. that provides Titan with an exclusive right to use the *Antik Denim* trademark for the sale of men's and women's footwear in the United States and its possessions and territories, Canada and Mexico, and a right of first refusal for similar use of the trademark in Europe and South America. In addition, on December 4, 2006 Antik entered into a binding Licensing Term Sheet with North Star International, Inc. pursuant to which the parties agreed to enter into a Licensing Agreement that provides North Star, or its designee, with a license to distribute Antik's knit apparel and hats in all categories for men and women bearing with an exclusive right to use Antik Denim trademark for the sale of men's and women's knitwear and hats in the United States and its possessions and territories, Canada and Mexico.

Our senior management team has significant experience in developing and marketing multiple premium denim products and brands, which we believe demonstrates a capability to implement our product strategy. Over the last thirty years, Mr. Guez, our Chairman, Chief Executive Officer and President, has engaged in the design, marketing, manufacturing and wholesale distribution of premium fashion and denim collections, including Sasson Jeans and more recently, a growing stable of contemporary brands, such as Duarte Jeans, Elvis, Memphis Blues and Grail Jeans. Our principal designers, Philippe Naouri and Alex Caugant, Jimmy Taverniti and Benjamin Taverniti have previously assisted world-renowned casual apparel companies such as Chevignon, Diesel, GOA, and Replay in the design and development of successful brands and products.

Operating Strategy

Our operating strategy is to continue to build on our strengths in brand development, marketing, distribution and product sourcing capabilities to become the leading company in the high fashion denim apparel industry. Our goal is to leverage the expertise and relationships gained by our executive management and product design teams' prior experience in creating and developing premium denim apparel brands, product sourcing and manufacturing in the U.S., Mexico and Asia, and distributing to high-end retail channels both domestically and internationally.

Historically, we have relied on the services and staff of companies affiliated with Mr. Paul Guez in several areas of our business operations. We are moving away from this model and we are in the process of building a team of professionals with significant prior experience and established relationships in the denim apparel industry to assume the responsibility for coordinating product manufacturing, material sourcing, and sales and marketing.

Growth Strategy

Our goal is to build a broad and diversified portfolio of brands and become a leading seller of premium denim products and accessories across a range of retail price points through our wholesale and retail distribution channels by focusing on the following key elements of our growth strategy:

Add Brands and Product Lines. We currently offer four highly differentiated, designer-driven brands. We will continue to use our extensive experience in the apparel industry to identify and evaluate strategic opportunities to acquire other businesses and to develop, license or acquire new brands. We seek to acquire or license additional businesses and brands that will contribute to our growth through additional sales revenue, name and brand recognition, and synergies with our existing brands. Our goal is to build a portfolio of lifestyle brands in the premium and better segments of the denim and apparel industry. In line with this strategy, in 2006, we entered into a joint venture with L&D and in early 2007, we entered into a licensing agreement with Faith to develop and distribute merchandise under the *Faith Connexion* brand. We are currently looking into integrating *Life & Death* as one of our brands.

Expand Retail Business. In order to take full advantage of our retail management team and infrastructure, and fully leverage our ability to increase gross margins through sale of our own products in our retail stores, we plan to grow our retail business by adding new stores in attractive markets and new locations in existing markets.

Expand Wholesale Distribution. We currently sell our products directly to major high-end department stores and boutiques in the United States, Canada, Japan and the European Union, and through distribution arrangements in a number of countries abroad. We plan to expand our wholesale distribution in several ways. Domestically, we plan to add retailers of high-end denim products that do not already sell our products. We will promote the sale of all of our brands to retailers that currently sell only one or two of our brands. We plan to expand the floor space and diversify the product lines of retailers who currently sell our products. Internationally, we will negotiate distribution agreements for territories where we do not already have a strong presence.

Continue to Diversify Product Lines. We have diversified our product lines, both by increasing the price point range for our denim products and adding complementary non-denim products. We also recently added a children's line to our men's and women's product lines. We will continue to sensibly diversify our product lines, particularly with new denim products and by expanding the selection of tops that we offer. We will also continue to evaluate licensing arrangements with quality manufacturers for ancillary products that we wish to add.

Our Products and Brands

We offer multiple brands of apparel in the premium and better denim segments. As a result of a license agreement with Yanuk Jeans, LLC, the acquisitions of Antik and Taverniti and our licensing agreement with Faith, we currently market our products under the *Antik Denim*, *Taverniti So Jeans, Faith Connexion* and *Yanuk* brands. We also plan to generate revenue from the sale of *Life & Death* branded products due to our joint venture with L&D and are currently looking into integrating *Life & Death* as one of our brands. Our products are sold in the United States and abroad to upscale retailers and boutiques. We currently sell men's and women's styles and have launched a children's line for both *Antik Denim* and *Taverniti So Jeans*. In addition, Antik is a party to a license agreement with Titan Industries, Inc. that provides Titan with an exclusive right to use the *Antik Denim* brand for the sale of men's and women's footwear in the United States, Canada and Mexico, and a right of first refusal for similar use of the brand in Europe and South America. The footwear line was launched in July 2006.

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

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

With the license of the *U* brand from Yanuk Jeans LLC, we plan to design, develop, market and distribute jeans and accessories under the *U* brand at price points different from those of *Antik Denim*, *Yanuk* and *Taverniti So Jeans*.

On December 4, 2006, Antik entered into a binding Licensing Term Sheet with North Star International, Inc., pursuant to which the parties agreed to enter into a Licensing Agreement whereby North Star, or its designee, will obtain a license to distribute Antik's knit apparel and hats in all categories for men and women bearing the Antik Denim trademark in the United States and internationally.

Marketing, Distribution and Sales

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

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

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

We intend to operate certain flagship stores domestically and to license overseas operators to open retail stores that focus on high end fashion denim generally, and the *Antik Denim*, *Yanuk*, *U* and *Taverniti So Jeans* brands, in particular. We also intend to explore a broader retail strategy focusing on the launch and operation of stores retailing our various brands. While there is no existing plan with respect to the roll-out of such stores, our first retail store was opened on August 27, 2005 on Melrose Avenue in Los Angeles and our second retail store was opened in September 2006 on Market Street in San Francisco.

Manufacturing and Sourcing

We purchase our fabric, thread and other raw materials from various industry suppliers within the United States and abroad. We do not currently have any long-term agreements in place for the supply of our fabric, thread or other raw materials. The fabric, thread and other raw materials used by us are available from a large number of suppliers worldwide. During the fiscal year ended December 31, 2006, only one supplier accounted for more than 10% of our raw material purchases. Purchases from that supplier were 10.3%. We have the ability to replace our suppliers of raw materials as needed without significantly affecting our business or operations.

We presently outsource all of our manufacturing needs to contract vendors using just in time ordering. We use several contract vendors for our manufacturing needs. We are increasing the use of contract manufacturers in Mexico and the Far East. We have been in discussions with one of our lead manufacturers to deliver us full package products which we believe will reduce various costs we incur in connection with assembling our products. We maintain rigorous quality control systems for both raw and finished goods. We will continue to outsource the majority of our production capacity to maintain low fixed expenses. We will add contract manufacturers as required to meet our needs. During the fiscal year ended December 31, 2006, two sub-contractors accounted for 22.5% and 16.4% of our manufacturing. One of these sub-contractors, which principally provided manufacturing services to Taverniti, is Azteca Production International Inc., a company co-owned by Paul Guez, our Chairman, Chief Executive Officer and President.

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

Competition

Our current competitors are companies that sell premium denim and apparel brands such as Levi Strauss, Calvin Klein, Joe’s Jeans, True Religion Apparel, Seven For All Mankind and Citizens of Humanity. Many of these competitors have greater financial resources, operating capacity, name recognition and market penetration. Sales of our products are affected by style, price, quality, brand reputation and general fashion trends.

We believe our portfolio of premium denim brands and broad international distribution relationships with high-end retailers position us for sustained growth and profitability. We intend to capitalize on the following competitive strengths to achieve these goals:

Innovative Concepts and Designs. Our products embody innovative concepts and designs with extraordinary fit and are made with high quality fabrics and finishes, treatments and embellishments, including our patent pending pockets, hand stitching and embroidery detail. Our competitive edge lies in our ability to sell quality products at competitive price points.

Recognized Design Teams. Each of our brands has an independent, highly talented design team developing distinct, trend setting looks. Philippe Naouri and Alexandre Caugant head the design team for *Antik Denim*. Philippe Naouri and Alexandre Caugant are also members of L&D and design *Life & Death* branded merchandize in connection with our joint venture with L&D. Both have significant experience in the denim industry in designing and selling vintage and vintage-inspired products. Jimmy Taverniti, a highly regarded Italian couture designer, heads the design team for *Taverniti So Jeans* and has over 25 years experience in the denim industry. Benjamin Taverniti, Jimmy Taverniti's son, heads the design team for *Yanuk* and has spent most of his life in denim design working with his father and on his own. *Faith Connexion* is designed in Europe, and is a full line of edge forward contemporary sportswear.

Multi-brand Strategy. Unlike our single-brand competitors, we own or have exclusive licenses to four principal brands, each one overseen by an independent design team. *Antik Denim* is based on vintage western styling with an urban flavor and incorporates a very unique and distinctive back pocket. *Yanuk* is a contemporary denim player with focus on fit and a clean, non-distressed look. *Taverniti So Jeans*, designed by Jimmy Taverniti, an Italian couture designer, is focused on soft fits and unique styling. *Faith Connexion* is a full line of premium junior sportswear. Maintaining multiple brands mitigates the risk associated with a downturn in sales from any one brand at any given time, which is particularly significant due to the cyclical and seasonal nature of sales and product performance in the fashion industry. We are currently looking into integrating *Life & Death* as one of our brands. *Life & Death* is a premium knit-wear collection also designed by Philippe Naouri and Alexandre Caugant.

Diversification of Product Lines. We manufacture extensive lines of premium denim products and accessories for women, men and children consistent with our brands across a range of retail price points. Our denim bottoms range in price at retail from $100 to $400. Non-denim products account for approximately 25% of our total sales, which we believe gives us the ability to transition from premium denim to luxury lifestyle brands. We recently introduced children's lines of our *Antik Denim* and *Taverniti So Jeans* brands, which have been well received by retailers and consumers. In July 2006, our licensee launched a footwear line for the *Antik Denim* brand.

Broad Distribution Network. We sell our products to high-end retailers and distributors in the United States and abroad. Our key domestic retailers include department stores such as Barney's, Bloomingdale's, Macy's, Neiman Marcus, Nordstrom and Saks, and boutiques such as Fred Segal. Our products have been distributed domestically in more than 1,000 boutiques. Internationally, our lines are offered in 32 countries on six continents. International sales accounted for approximately 23% of sales in 2006.

Retail Strategy. By selling directly to consumers at retail prices, which are higher than wholesale prices, we expect to increase gross margins and profitability as we gradually increase the number of our retail stores. We will also be able to test new brands and product concepts in a cost-effective way prior to full launch.

Experienced Management Team. Our senior management team has significant experience in developing and marketing multiple premium denim products and brands, which we believe demonstrates a capability to implement our product strategy. Over the last thirty years, Mr. Guez, our Chairman, Chief Executive Officer and President, has engaged in the design, marketing, manufacturing and wholesale distribution of premium fashion and denim collections, including Sasson Jeans and more recently, a growing stable of contemporary brands, such as Duarte Jeans, Elvis, Memphis Blues and Grail Jeans. Our principal designers, Philippe Naouri, Alex Caugant, Jimmy Taverniti and Benjamin Taverniti have previously assisted world-renowned casual apparel companies such as Chevignon, Diesel, GOA, and Replay in the design and development of successful brands and products. Larry J. Jacobs, our Chief Financial Officer, has 30 years of financial, accounting and operational experience in the apparel business. Scott J. Drake, our President of Sales and Chief Operating Officer, has over 25 years of experience in the apparel business.

Trademarks and Other Intellectual Property

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

Taverniti is the exclusive licensee for the design, development, manufacture, sale, marketing and distribution of the *Taverniti So Jeans* trademark in the denim and knit sportswear categories for men and women. It is paying royalties to Taverniti Holdings LLC in the range of five to eight percent depending on the net sales of the licensed products pursuant to a license agreement with Taverniti Holdings LLC. Taverniti Holdings LLC is jointly owned by Paul Guez (60%) and Jimmy Taverniti (40%), the designer of the products for the brand, and Mr. Guez is the sole manager. The license agreement was signed in May 2004 and expires on December 31, 2015.

During 2006, we acquired a 50% ownership interest in L&D, a full knit wear collection venture which is in the development stage. L&D holds a trademark application for the *Life &* Death mark in the United States. Recently, we entered into a licensing agreement with Faith, a French company, specialized in premium junior sportswear. Faith holds trademark applications for the *Faith Connexion* mark in the United States and holds registrations for the mark abroad.

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

Government Regulation and Supervision

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

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

Design and Development

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

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

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

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

Faith Connexion. Faith Connexion is designed in Europe, and is a full line of edge forward contemporary sportswear.

Mr. Guez participates in design efforts and provides significant input with respect to the development of new lines and brands. We do not have in place any formal design and development plan at this time. We are, however, looking into integrating *Life & Death* as one of our brands. The designers of *Life & Death* are also Philippe Naouri and Alexandre Caugant. *Life & Death* is casual life style knit wear line, with Gothic and Latin favor. Since our inception in 2004, we have allocated significant resources to our design and development activities. In the fiscal year ended December 31, 2006, our design and development expenses were approximately $2.3 million.

Employees

As of March 26, 2007, we had 124 employees, not including our two executive officers, Paul Guez, our Chairman, Chief Executive Officer and President, and Larry Jacobs, our Chief Financial Officer and Secretary. Mr. Guez leads our product development, marketing and sales, and Mr. Jacobs oversees all financial aspects of our business. Our employees are not unionized. Except for agreements with Messrs. Naouri and Caugant, who comprise the design team for our *Antik Denim* brand, no employees, including our executive officers, are subject to existing employment agreements with us.

Available Information

We file annual, quarterly and current reports, proxy statements and other information with the U.S. Securities and Exchange Commission (“SEC”). Copies of this Annual Report on Form 10-KSB and each of our other periodic and current reports, and amendments to all such reports, that we file or furnish pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 are available free of charge on our website (www.blueholdings.com) as soon as reasonably practicable after the material is electronically filed with, or furnished to, the SEC. The information contained on our website is not incorporated by reference into this Annual Report on Form 10-KSB and should not be considered part of this Annual Report on Form 10-KSB.

In addition, you may read and copy any document we file with the SEC at the SEC’s Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the operation of the Public Reference Room. Our SEC filings are also available to the public at the SEC’s web site at http://www.sec.gov, which contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC.

ITEM 2. Description of Property

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

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

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

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

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

ITEM 3. Legal Proceedings

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

In August and September, 2005, the Company filed complaints against a number of companies that we believe encroached on our highly identifiable, stylized "Antik" pocket design. The complaints were filed in the United States District Court in Los Angeles, California. The unique design in question is copyrighted, and is the subject of pending trademark and design patent registration claims. The complaints alleged, among other matters, that the companies were violating federal and state trademark, copyright, unfair trade practices and unfair competition statutes and laws, and sought damages and injunctive relief against all parties. During the year ended December 31, 2006, we entered into settlements and received approximately $634,500 in final settlements.

On November 29, 2006, Antik Batik, S.A.R.L. filed an opposition proceeding with the United States Trademark Trial and Appeal Board (Opposition No. 911742226) against Antik, alleging that if the U.S. Patent and Trademark Office issues a federal trademark registration for the mark ANTIK DENIM as applied for by Antik, opposer's rights in its previously registered mark ANTIK BATIK will be harmed. The action seeks no monetary relief, but only an order instruction the U.S. Patent and Trademark Office to refuse to register Antik's ANTIK DENIM mark. We vigorously dispute opposer's contentions. Discovery has not yet commenced, and at this time we cannot express an opinion as to the likely outcome of the opposition proceeding.

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

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

ITEM 4. Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of the Company's shareholders in the quarter ended December 31, 2006.

PART II

ITEM 5. Market for Common Equity and Related Stockholder Matters

Common Stock

Our common stock is quoted on the NASDAQ Capital Market under the symbol "BLUE." The following table sets forth, for the periods indicated, the high and low closing sales prices for the common stock for each quarter within the last two fiscal years as reported by the NASDAQ Stock Market. The information has been adjusted to reflect a 1-for-29 reverse stock split of our common stock which took effect on June 7, 2005.

	High		Low	
Year Ended December 31, 2005				
First Quarter	$	17.11	$	1.16
Second Quarter	$	25.52	$	4.64
Third Quarter	$	10.10	$	6.98
Fourth Quarter	$	8.85	$	4.75
Year Ended December 31, 2006				
First Quarter	$	6.21	$	4.90
Second Quarter	$	6.70	$	4.92
Third Quarter	$	5.45	$	4.33
Fourth Quarter	$	4.46	$	1.50

On March 26, 2007, the closing sales price of our common stock as reported on the NASDAQ Stock Market was $1.60 per share.

Holders of Common Stock

As of March 26, 2007, there were 90 record holders of our common stock, with 26,057,200 shares outstanding. The number of holders of record is based on the actual number of holders registered on the books of our transfer agent and does not reflect holders of shares in "street name" or persons, partnerships, associations, corporations or other entities identified in security position listings maintained by depository trust companies.

Dividend Rights

Subject to preferences that may apply to shares of preferred stock outstanding at the time, the holders of outstanding shares of our common stock are entitled to receive dividends out of funds legally available at the times and in the amounts that our board may determine. We have not paid any dividends in the past and have no current plan to pay any dividends. We intend to devote all funds to the operation of our businesses.

Equity Compensation Plan Information

The following table sets forth information concerning our equity compensation plans as of December 31, 2006.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders (1)	335,500	$ 5.75	2,164,500
Equity compensation plans not approved by security holders	--	--	--
Total	335,500	$ 5.75	2,164,500

(1) Plan represents the 2005 Incentive Stock Option Plan.

ITEM 6. Management's Discussion and Analysis of Financial Condition and Results of Operation

The following discussion and analysis should be read together with the Consolidated Financial Statements of Blue Holdings, Inc. and the Notes to Consolidated Financial Statements included elsewhere in this Annual Report on Form 10-KSB. This discussion summarizes the significant factors affecting our operating results, financial conditions and liquidity and cash-flow for the fiscal years ended December 31, 2005 and 2006. This discussion contains forward looking statements that involve risks and uncertainties and are based on judgments concerning various factors that are beyond our control. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including those discussed below and elsewhere in this Annual Report on Form 10-KSB, particularly under the caption "Cautionary Note Regarding Forward Looking Statements" and in Item 1. Business under the caption "Risk Factors."

Overview

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

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

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

On April 14, 2005, we entered into an Exchange Agreement (the “Exchange Agreement”) pursuant to which Antik Denim, LLC, a California limited liability company (“Antik”), became our wholly-owned subsidiary and the members of Antik (the “Antik Members”) became our majority shareholders. The closing of the transactions contemplated by the Exchange Agreement occurred on April 29, 2005. The exchange transaction was accounted for as a reverse merger (recapitalization) with Antik deemed to be the accounting acquirer, and us deemed to be the legal acquirer.

On July 5, 2005, we entered into a license agreement with Yanuk Jeans LLC, a company owned by Paul Guez, to sell products under the “Yanuk” label. This agreement became effective from July 1, 2005 and will expire on June 30, 2015. On October 6, 2005, we also entered into a five-year license agreement with Yanuk Jeans LLC, effective October 5, 2005. Under the terms of the agreement, we became the exclusive licensor for the design, development, manufacture, sale, marketing and distribution of Yanuk Jeans LLC’s *U* brand products to the wholesale and retail trade.

On October 31, 2005, we entered into an exchange agreement with Taverniti So Jeans, LLC, a California limited liability company ("Taverniti"), and the members of Taverniti (the "Taverniti Members") pursuant to which Taverniti became our wholly-owned subsidiary.

Significant Developments

During fiscal 2006 we entered into the following significant transactions:

- On March 31, 2006, we entered into a Letter of Intent with Global Fashion Group, SA ("Global Fashion Group") to form a new joint venture company which would have a license to produce, manufacture and distribute apparel and accessories for our three principal brands, *Antik Denim*, *Taverniti So Jeans* and *Yanuk*, throughout Europe and other territories. The initial term of the license was for two years, with automatic renewal for an additional three-year term if the joint venture achieved target net sales and was not in breach of the license. Under the terms of the Letter of Intent, the joint venture would pay to us a royalty of fifteen percent (15%) of all net sales of the licensed products and would pay guaranteed minimum royalties on an annual basis in the aggregate amount of €13.4 million through 2010 assuming the license to the joint venture is renewed. The Letter of Intent provided for an upfront initial license fee of €200,000. The joint venture would have a right of first refusal to license future brands developed by us and neither the joint venture nor Global Fashion Group would be permitted to engage in competitive activities with respect to the products licensed to the joint venture during the term of the license. On October 5, 2006, we agreed to terminate the Letter of Intent previously entered into with Global Fashion Group because we were unable to come to an agreement with Global Fashion Group on the final terms of the license to be held by the joint venture company contemplated under the Letter of Intent.

- On June 19, 2006, we entered into an Agreement and Plan of Merger (the "Merger Agreement") with LR Acquisition Corporation, a District of Columbia corporation and our wholly-owned subsidiary ("LR Acquisition"), Long Rap, Inc., a District of Columbia corporation ("Long Rap"), the stockholders of Long Rap and Charles Rendelman, as the Long Rap stockholders' representative, pursuant to which LR Acquisition would merge (the "Merger") with and into Long Rap with Long Rap surviving the Merger as our wholly-owned subsidiary. Each holder of an outstanding share of the common stock of Long Rap would receive, as merger consideration, (1) an amount of cash equal to $16,000,000 divided by the outstanding shares of the common stock of Long Rap on a fully-diluted basis, and (2) that number of shares obtained by dividing (A) $16,000,000 divided by the closing price of a share of our common stock, as quoted on the NASDAQ Capital Market, over the ten trading days immediately preceding the effective time of the merger by (B) the number of shares of the common stock of Long Rap on a fully-diluted basis. On October 10, 2006, we mutually agreed with Long Rap to terminate the Merger Agreement. We determined, along with Long Rap, that it would not be in the best interests of our respective stockholders to proceed with the Merger.

- On September 15, 2006, we entered into a Joint Venture Agreement Term Sheet with Philippe Naouri and Alexandre Caugant, the members of Life & Death, LLC, pursuant to which we acquired 50% of the membership interests of L&D. L&D owns the *Life & Death* trademark application and designs, develops, manufactures and distributes knit apparel under the brand *Life & Death*. We share 50% in the profits and losses of L&D based on our membership interest in L&D. Alexandre Caugant and Philippe Naouri are the principal designers of *Life & Death*.

- On December 4, 2006, Antik entered into a binding Licensing Term Sheet with North Star International, Inc., pursuant to which the parties agree to enter into a Licensing Agreement whereby North Star, or its designee, will obtain a license to distribute Antik's knit apparel and hats in all categories for men and women bearing the Antik Denim trademark in the United States and internationally. The license will have a term of 66 months commencing on October 1, 2006, and will be subject to five renewal options for one-year terms. Pursuant to the terms of the Licensing Term Sheet, upon execution of the Licensing Term Sheet North Star paid Antik a fee of $180,000 as an advance against royalties. North Star will also pay Antik royalties of 4.5% of net sales up to $4 million, and 10% of net sales thereafter, during the first 18 months of the term, and 10% of all net sales thereafter. North Star has also guaranteed certain minimum net sales during the term of the license. For each renewal term, the minimum net sales guaranty will increase by 10% over the previous year's minimum net sales guaranty. The Licensing Term Sheet also provides that disputes involving the license shall be settled by binding arbitration.

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

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

Inventories

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

Income Taxes:

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

Recent Accounting Pronouncements and Developments

In June 2006, the Financial Accounting Standards Board ("FASB") issued FIN 48, "Accounting for Uncertainty in Income Taxes--an interpretation of FASB Statement No. 109," which seeks to reduce the diversity in practice associated with the accounting and reporting for uncertainty in income tax positions. This Interpretation prescribes a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of uncertain tax positions taken or expected to be taken in an income tax return. FIN 48 presents a two-step process for evaluating a tax position. The first step is to determine whether it is more-likely-than-not that a tax position will be sustained upon examination, based on the technical merits of the position. The second step is to measure the benefit to be recorded from tax positions that meet the more-likely-than-not recognition threshold, by determining the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement, and recognizing that amount in the financial statements. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company does not believe the impact that the adoption of FIN 48 will have a material effect on its results of operations, financial position, and cash flows.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements," which provides enhanced guidance for using fair value to measure assets and liabilities. SFAS No. 157 provides a common definition of fair value and establishes a framework to make the measurement of fair value in generally accepted accounting principles more consistent and comparable. SFAS No. 157 also requires expanded disclosures to provide information about the extent to which fair value is used to measure assets and liabilities, the methods and assumptions used to measure fair value, and the effect of fair value measures on earnings. SFAS No. 157 is effective for financial statements issued in fiscal years beginning after November 15, 2007 and to interim periods within those fiscal years. We do not believe the adoption of SFAS No. 157 will have a material, if any, effect on our results of operations, financial position, or cash flows.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin (“SAB”) No. 108, “Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements”. SAB No. 108 was issued in order to eliminate the diversity in practice surrounding how public companies quantify financial statement misstatements. SAB No. 108 requires that registrants quantify errors using both a balance sheet (iron curtain) approach and an income statement (rollover) approach then evaluate whether either approach results in a misstated amount, that, when all relevant quantitative and qualitative factors are considered, is material. SAB No. 108 is effective for fiscal years ending after November 15, 2006. We adopted the bulletin during 2006. The adoption did not have a material effect on our consolidated results of operations, financial position, or cash flows.

In September 2006, the FASB issued SFAS No. 158 *Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans*, which will require the Company to recognize the funded status of defined benefit plans in its statement of financial position. This statement will be effective as of the Company’s year ending August 31, 2007. We have no defined benefit plan and believe this SFAS will have no effect on us.

Results of Operations

The acquisition of Antik Denim, LLC (“Antik”) is accounted for as a reverse merger (recapitalization) in the accompanying financial statements with Antik deemed to be the accounting acquirer, and Blue Holdings deemed to be the legal acquirer. The exchange transaction with Taverniti So Jeans LLC is accounted for as a combination of entities under common control, and its 2004 and 2005 results are combined with those of Antik and Blue Holdings, Inc., respectively. Accordingly, our results of operations before the completion of these transactions, including our operating results before April 29, 2005 (when we completed the acquisition of Antik), reflect the operations of Antik and Taverniti.

<u>Year ended December 31, 2006 compared to Year ended December 31, 2005</u>

Net sales increased from $36.4 million for the year ended December 31, 2005 to $48.9 million for the year ended December 31, 2006. The increase in sales was primarily due to a strong demand for our brands in the United States and abroad. Our international sales increased from 17.2% in 2005 to 23% in 2006, of the net sales. Out of the net sales of $48.9 million, Antik accounted for 50% of the total, Taverniti 37.4% and Yanuk 12.6%. The increase was less than expected due to the cancellation of orders caused by production delays of a major supplier in the third quarter. These delays temporarily caused major retail partners to hold back sales orders and the failure of a major European distributor to fulfill its projections and caused a reduction in our previously anticipated sales increase.

Cost of goods sold increased from 50.6% of sales to 73.3% from 2005 to 2006. The increase was due to substantial inventory markdowns and allowances recorded in the 2006 and the sale of some items of inventory at lower prices (i.e., at off price).

As a percentage of net sales, gross profit decreased from 49.4% of sales to 26.7% from 2005 to 2006. The substantial reduction in gross profit is largely attributable to an inventory adjustment the company made in the fourth quarter. During the fourth quarter of 2006, our management performed a review of our inventory and determined that certain raw material and finished goods inventory needed to be adjusted to net realizable value due to changes in the market and in our design and merchandizing directions. As such, we marked down finished goods by $2.3 million, fabric by $1.7 million and other inventory items by $1.4 million, resulting in total inventory adjustments of $5.4 million. In the first quarter of 2007, we plan to dispose of a substantial portion of inventory at off price but in excess of its closing value.

Selling, distribution and administrative expenses for the twelve months ended December 31, 2006 totaled $16.8 million compared with $10.5 million during the same period last year. The increase was caused by the expansion of overhead at the beginning of the year in anticipation of higher revenue and higher sales projections and resources and expenses committed to the terminated transaction with Long Rap, Inc. During the year ended December 31, 2006, the principal components of selling, distribution and administrative expenses were payroll ($6.9 million), royalties ($1.3 million), legal and professional ($0.8 million) and advertising ($0.6 million).

Income (loss) before other expenses was $(4 million) as compare with $7.5 million during the years ended December 31, 2006 and 2005, respectively. The primary reasons were due to lower gross profit during 2006 caused by inventory adjustments and markdowns, sale of some items of inventory at off price, an accounts receivable reserve of $0.5 million, and higher overhead costs incurred in anticipation of higher revenues during 2006.

Income (loss) before provision for income taxes was $(5.4 million) for the year ended December 31, 2006, as compared with $6.8 million for the same period last year.

During the year, we spent $0.9 million on interest expenses as compare with $0.1 million in the same period last year. Also, during the year ended December 31, 2006, we spent $0.4 million on the acquisition of Long Rap, Inc. (a deal that did not materialize) and also recorded a loss of $0.2 million in our joint venture investment with L&D.

As of December 31, 2006 and 2005, the provision (benefit) for income taxes were $(0.7) million and $1.7 million, respectively. The provision for income tax includes a valuation allowance of $1.4 million of deferred tax assets previously recorded.

Net income (loss) for the year ended December 31, 2006 was $(4.8 million) or 9.7% of net sales compared to $5.1 million or 14.1% of net sales during the same period last year. During the year ended December 31, 2006, basic and diluted earnings (loss) per share were $(0.18), compared to $0.20 per share in the same period of the last year.

Liquidity and Capital Resources

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

For the year ended December 31, 2006, net cash used in operating activities was $5.7 million. The deficit was primarily due to an increase of $0.7 million in due from factor, $2.1 million in income tax receivable and other current assets and $3.4 million in accounts receivables and was offset by an increase in due to customers of $0.6 million and an increase in other current liabilities of $0.9 million. Net cash provided by financing activities was $7.2 million that included $5.4 million from short-term borrowings and $1.8 million advanced from our majority shareholder. We utilized $1.6 million in investing activities which primarily consisted of $1.2 for leasehold improvements at our new store in San Francisco.

For the year ended December 31, 2005, net cash used in operating activities was $4.2 million. The deficit was primarily due to an increase of $7.8 million in inventory, $0.3 million in due from factor and $4.2 million in accounts receivables. Net cash provided by financing activities was $5.3 million consisting of short-term borrowings of $4.6 million, and $0.7 million in cash contribution by shareholders. The Company utilized $0.95 million in investing activities which consisted of the purchase of equipment for $0.2 million and a deemed distribution of $750,000 made to previous members of Taverniti So Jeans, LLC as part of the consideration for our purchase of all their respective membership interests in October 2005.

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

The factor agreements provide that we can obtain an amount up to 90% of the value of our purchased customer invoices, less a reserve of 10% of unpaid accounts purchased and 100% of all accounts that are disputed. The factor agreements provide for the automatic renewal of the agreements after July 24, 2006, subject to 120 days' termination notice from any party. We receive amounts against purchased customer invoices on a recourse basis or a non-recourse basis under these agreements. Amounts received against customer invoices purchased on a recourse basis are classified as "short-term borrowings" and amounts received against customer invoices purchased on a non-recourse basis are reflected on a net basis against such receivables purchased by the factor in "due from factor" on the balance sheets included in our financial statements.

In addition, the factor also makes available to all three companies a combined line of credit up to the lesser of $2.4 million (increased from $1.5 million effective as of January 1, 2006) and 50% of the value of eligible raw materials and finished goods. The increase in this line of credit - from $1.5 million to $2.4 million - became effective as of January 1, 2006. As of December 31, 2006, we drew down $2.4 million of this credit line.

As of December 31, 2006, the amount of the reserve held by the factor was approximately $1.2 million. Before January 1, 2006, the factor commission was 0.8% of the customer invoice amount for terms up to 90 days, plus one quarter of one percent (.25%) for each additional thirty-day term. Effective January 1, 2006, the factor commission is 0.75% if the aggregate amount of approved invoices is below $10 million per annum, and will be reduced by 5 basis points for each increase by $10 million in the aggregate amount of approved invoices. We are contingently liable to the factor for merchandise disputes, customer claims and the like on receivables sold to the factor. To the extent that we draw funds prior to the deemed collection date of the accounts receivable sold to the factor, interest is charged at the rate of 1% over the factor's prime lending rate per annum. Factor advances and ledger debt are collateralized by the non-factored accounts receivable, inventories and the personal guarantees of Paul Guez, our Chairman, Chief Executive Officer, President and majority shareholder, and the living trust of Paul and Elizabeth Guez.

The factor also purchased customer invoices on a "with recourse" basis. These advances and the advances against inventory were classified as "short-term borrowings." These short-term borrowings amounted to $10.0 million as of December 31, 2006. The factor commission is 0.4% for receivables purchased subject to recourse. Receivables subject to recourse approximated $9.3 million net of reserves as of December 31, 2006. Although the arrangement with our factor is important to our liquidity and capital resources, management believes that cash flow from operations, and our ability to obtain other debt or equity financing, permits us to adequately support and manage our ongoing operations.

From time to time, our majority shareholder, Mr. Paul Guez, made advances to us to support our working capital needs. These advances were non-interest bearing. On July 1, 2006, Mr. Guez converted the advances to a line of credit in an agreement with us. The line of credit allows us to borrow from him up to a maximum of $3 million at an annual interest rate of 6%. We may repay the advances in full or in part at any time until the credit line expires on December 31, 2007. As of December 31, 2006, the balance of these advances was $1.9 million.

Our primary source of liquidity is expected to be cash flow generated from operations, cash and cash equivalents currently on hand, and working capital attainable through our factor. We anticipate a tax recovery and refund in the range of $2.4 to $3.6 million during 2007. We may seek to finance future capital needs through various means and channels, such as issuance of long-term debt or sale of equity securities.

Off-Balance Sheet Arrangements

Financial instruments that potentially subject us to off-balance sheet risk consist of factored accounts receivable. We sell certain of our trade accounts receivable to a factor and are contingently liable to the factor for merchandise disputes and other customer claims.

As of December 31, 2006, the factor held $3,467,752 of accounts receivable purchased from us on a without recourse basis and had made advances to us of $1,922,363 against those receivables, resulting in a net balance due from the factor of $1,366,588, net of reserves of $178,801, as of December 31, 2006. The Company has accounted for the sale of receivables to the factor in accordance with SFAS No. 140, "Accounting for the Transfers and Servicing of Financial Assets and Extinguishments of Liabilities."

Contractual Obligations

The following summarizes our contractual obligations at December 31, 2006 and the effects such obligations are expected to have on liquidity and cash flow in future periods:

	Payments due by period						
	Total	**2007**	**2008**	**2009**	**2010**	**2011**	**Thereafter**
Guaranteed Minimum Royalties	2,702,500	275,000	752,500	1,212,500	312,500	150,000	-
Employment contracts	1,326,452	480,000	480,000	366,452	0	0	-
Lease obligations	5,573,161	554,758	569,401	584,449	576,860	592,757	2,694,936
Total contractual obligations	9,602,113	1,309,758	1,801,901	2,163,401	889,360	742,757	2,694,936

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

On July 5, 2005, we entered into a ten-year license agreement with Yanuk Jeans LLC, effective July 1, 2005. Under the terms of the agreement, we became the exclusive licensor for the design, development, manufacture, sale, marketing and distribution of Yanuk Jeans LLC's "Yanuk" brand products. We pay to Yanuk Jeans LLC a royalty of six percent of all net sales of such products and shall pay a guaranteed minimum royalty on a quarterly basis. Also we have the option to purchase from Yanuk Jeans LLC the property licensed under the agreement.

On September 8, 2005, Antik entered into a license agreement with Titan Industries, Inc. that provides Titan with an exclusive right to use the "Antik Denim" trademark for the sale of men's and women's footwear in the United States and its possessions and territories, Canada and Mexico, and a right of first refusal for similar use of the trademark in

Europe and South America.

On October 6, 2005, we entered into a five-year license agreement with Yanuk Jeans LLC, effective October 5, 2005. Under the terms of the agreement, we became the exclusive licensor for the design, development, manufacture, sale, marketing and distribution of Yanuk Jeans LLC's "U" brand products to the wholesale and retail trade. We pay to Yanuk Jeans LLC a royalty of five percent of all net sales of the licensed products and shall pay a guaranteed minimum royalty on an annual basis. In addition, during the term of the license agreement, the Company has the option to purchase from Yanuk Jeans LLC the property licensed under the agreement.

On July 8, 2005, we entered into an Employment Agreement with Philippe Naouri. This agreement was amended on August 23, 2005. Pursuant to the terms of Mr. Naouri's employment agreement, as amended, Mr. Naouri was engaged by us as the President of Antik for a term of 5 years commencing on July 11, 2005 and terminating on July 10, 2010. Mr. Naouri will receive an annual salary of $240,000 and is entitled to participate in our bonus, incentive, stock option, savings, welfare benefit and retirement plans as he becomes eligible. The parties to the Employment Agreement have agreed to resolve all disputes arising under the Employment Agreement through binding arbitration.

On November 14, 2005, we entered into an Employment Agreement with Mr. Alex Caugant. Mr. Caugant was engaged by Antik as a Senior Vice President for a term of 5 years commencing on November 14, 2005 and terminating on November 13, 2010. Mr. Caugant will receive an annual salary of $240,000 and is entitled to participate in our bonus, incentive, stock option, savings, welfare benefit and retirement plans as he becomes eligible. The parties to the Employment Agreement have agreed to resolve all disputes arising under the Employment Agreement through binding arbitration.

On August 27, 2005, we opened a retail store on Melrose Avenue, Los Angeles, California and took over all the obligations of a 10-year property lease which was entered into by Blue Concept LLC in April 2005. The lease will expire on March 15, 2015. More recently, on July 18, 2006, we entered into lease agreements with Emporium Development, L.L.C. ("Emporium") to lease approximately 3,272 square feet of space located at 865 Market Street, San Francisco, California 94103. The lease will expire on January 31, 2017.

RISK FACTORS

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

Risks Related to Our Business

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

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

21

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

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

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

We may require additional capital in the future.

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

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

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

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

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

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

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

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

Our operating results may fluctuate significantly.

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

- the timing of our introduction of new product lines;
- the level of consumer acceptance of each new product line;
- general economic and industry conditions that affect consumer spending and retailer purchasing;
- the availability of manufacturing capacity;
- the seasonality of the markets in which we participate;
- the timing of trade shows;
- the product mix of customer orders;
- the timing of the placement or cancellation of customer orders;
- the weather;
- transportation delays;
- quotas and other regulatory matters;
- the occurrence of charge backs in excess of reserves; and

- the timing of expenditures in anticipation of increased sales and actions of competitors.

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

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

We have one customer who accounted for approximately 42% of our total receivables at December 31, 2006 and two customers who accounted for 16.1% and 12.1%, respectively, of our sales for the fiscal year ended December 31, 2006. A decrease in business from or loss of any significant customer would have a material adverse effect on our results of operations. Additionally, certain retailers, including some of our customers, have experienced in the past, and may experience in the future, financial difficulties, which increase the risk of extending credit to such retailers and the risk that financial failure will eliminate a customer entirely. These retailers have attempted to improve their own operating efficiencies by concentrating their purchasing power among a narrowing group of vendors. There can be no assurance that we will remain a preferred vendor for our existing customers. Further, there can be no assurance that our factor will approve the extension of credit to certain retail customers in the future. If a customer's credit is not approved by the factor, we could assume the collection risk on sales to the customer itself, require that the customer provide a letter of credit, or choose not to make sales to the customer.

Our business is subject to risks associated with importing products.

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

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

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

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

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

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

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

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

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

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

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

We have been reducing our reliance on domestic contractors and expanding our use of offshore manufacturers as a cost-effective means to produce our products. During the year ended December 31, 2006, we sourced a significant majority of our finished products from suppliers located outside the United States and we also continued to increase our purchase of fabrics outside the United States. In addition, we have been increasing our international sales of product primarily through our licensees and distributors.

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

- Political instability or acts of terrorism, which disrupt trade with the countries in which our contractors, suppliers or customers are located;
- Local business practices that do not conform to legal or ethical guidelines;
- Adoption of additional or revised quotas, restrictions or regulations relating to imports or exports;
- Additional or increased customs duties, tariffs, taxes and other charges on imports;

25

- Significant fluctuations in the value of the dollar against foreign currencies;
- Increased difficulty in protecting our intellectual property rights in foreign jurisdictions;
- Social, legal or economic instability in the foreign markets in which we do business, which could influence our ability to sell our products in these international markets; and
- Restrictions on the transfer of funds between the United States and foreign jurisdictions.

Risks Related to Our Industry

Our sales are heavily influenced by general economic cycles.

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

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

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

- anticipating and quickly responding to changing consumer demands;
- developing innovative, high-quality products in sizes and styles that appeal to consumers;
- competitively pricing our products and achieving customer perception of value; and
- the need to provide strong and effective marketing support.

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

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

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

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

- the markets in which we operate;

- holiday seasons;
- consumer demand;
- climate;
- economic conditions; and

26

· numerous other factors beyond our control.

Difficulty in managing anticipated growth could have a material adverse impact on our business and operating results.

We anticipate growing our business in part through the acquisition of additional companies and/or license of additional brands depending upon a company's and/or a brand's sales revenues, name and brand recognition, and/or synergies with our existing brands. The acquisition and integration of these businesses and or brands will be complex and time and resource-consuming, and our management will have to dedicate substantial effort to it. These efforts could divert management's focus and resources from other strategic opportunities and from operational matters during the integration process, which could adversely impact our business and operating results.

Other Risks Related to Our Stock

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

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

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

As of March 26, 2007, our Chief Executive Officer, Paul Guez, and two members of our design team, Messrs. Naouri and Caugant, owned approximately 78% of the outstanding shares of our common stock. Paul and Elizabeth Guez, Mr. Guez's wife and our former Chief Operating Officer, alone owned approximately 72% of the outstanding shares of our common stock at March 26, 2007. Accordingly, our executive officers and key personnel have the ability to affect the outcome of, or exert considerable influence over, all matters requiring shareholder approval, including the election and removal of directors and any change in control. This concentration of ownership of our common stock could have the effect of delaying or preventing a change of control of us or otherwise discouraging or preventing a potential acquirer from attempting to obtain control of us. This, in turn, could have a negative effect on the market price of our common stock. It could also prevent our shareholders from realizing a premium over the market prices for their shares of common stock.

Our stock price has been volatile.

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

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

Absence of dividends could reduce our attractiveness to investors.

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

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

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

The issuance of any preferred stock may:

- make it difficult for any party to acquire us, even though an acquisition might be beneficial to our stockholders;
- delay, defer or prevent a change in control of our company;
- discourage bids for the common stock at a premium over the market price of our common stock;
- adversely affect the voting and other rights of the holders of our common stock; and
- discourage acquisition proposals or tender offers for our shares.

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

ITEM 7. **Financial Statements**

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Blue Holdings, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of Blue Holdings, Inc. and Subsidiaries as of December 31, 2006 and 2005 and the related consolidated statements of operations, stockholders' equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Blue Holdings, Inc. and Subsidiaries as at December 31, 2006 and 2005 and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2 to the consolidated financial statements, effective January 1, 2006 the Company adopted Statement of Financial Accounting Standard ("SFAS"), "Share-Based Payment" ("SFAS 123(R)") which requires companies to estimate the fair value of share-based payment awards on the date of grant using an option-pricing model.

/s/ Weinberg & Company, P.A.

Los Angeles, California
March 27, 2007

BLUE HOLDINGS INC. (FORMERLY KNOWN AS MARINE JET TECHNOLOGY CORP.) AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
December 31, 2006 and 2005

		2006		2005
ASSETS				
Current assets:				
Cash	$	109,031	$	228,127
Due from factor, net of reserves of $178,801 and $96,849, respectively		1,366,588		693,474
Accounts receivable, net of reserves of $901,941 and $484,421, respectively:				
- Purchased by factor with recourse		7,662,198		4,287,163
- Others		19,312		2,504
Inventories, net of reserves of $1,742,893 and $0, respectively		5,394,006		9,925,162
Due from related parties		-		15,974
Income taxes receivable		2,030,919		-
Deferred income taxes		2,488,082		492,574
Prepaid expenses and other current assets		396,810		351,919
Total current assets		19,466,946		15,996,897
Deferred income taxes		-		1,671,135
Property and equipment, less accumulated depreciation		1,611,171		198,927
Total assets	$	21,078,117	$	17,866,959
LIABILITIES AND STOCKHOLDERS' EQUITY				
Current liabilities:				
Bank overdraft	$	266,788	$	616,020
Accounts payable		2,820,024		2,911,598
Short-term borrowings		10,026,814		4,583,936
Due to related parties		710,153		372,311
Advances from majority shareholder		1,876,991		96,875
Income taxes payable		-		650,468
Accrued expenses and other current liabilities		2,133,932		599,166
Total current liabilities		17,834,702		9,830,374
Stockholders' equity:				
Common stock $0.001 par value, 75,000,000 shares authorized, 26,057,200 shares issued and outstanding		26,057		26,057
Additional paid-in capital		4,964,091		4,996,752
Retained earnings (deficit)		(1,746,733)		3,013,776
Total stockholders' equity		3,243,415		8,036,585
Total liabilities and stockholders' equity	$	21,078,117	$	17,866,959

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

F-3

BLUE HOLDINGS INC. (FORMERLY KNOWN AS MARINE JET TECHNOLOGY CORP.) AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005

		2006		2005
Net sales	$	48,996,375	$	36,365,205
Cost of goods sold		35,921,394		18,384,869
Gross profit		13,074,981		17,980,336
Selling, distribution & administrative expenses		17,082,936		10,490,023
Income (loss) before other expenses and provision for income taxes		(4,007,955)		7,490,313
Other expenses:				
Interest expense		993,814		122,434
Expenses relating to abandoned acquisition of Long Rap, Inc.		437,010		-
Expenses relating to exchange transaction		-		527,617
Total other expenses		1,430,824		650,051
Income (loss) before provision for income taxes		(5,438,779)		6,840,262
Provision (benefit) for income taxes		(678,270)		1,700,651
Net income (loss)	$	(4,760,509)	$	5,139,611
Net income (loss) per common share, basic and diluted	$	(0.18)	$	0.20
Weighted average shares outstanding, basic and diluted		26,057,200		25,698,539

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

F-4

BLUE HOLDINGS INC. (FORMERLY KNOWN AS MARINE JET TECHNOLOGY CORP.) AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005

	Members Equity		Shares Issued				
	Antik	Taverniti	Number	Par Value 0.001	Additional Paid In Capital	Retained Earnings	Total
Balance, January 1, 2005	$ 39,056	$ (143,581)	-	-	-	-	(104,525)
Contributions	1,886,200	-	-				