INNOVO GROUP INC
Form 10-Q
July 10, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended May 26, 2007

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission File Number: 0-18926

INNOVO GROUP INC.

(Exact name of registrant as specified in its charter)

Delaware	**11-2928178**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

5901 South Eastern Avenue, Commerce, California	**90040**
(Address of principal executive offices)	(Zip Code)

(323) 837-3700

(Registrant s telephone number, including area code)

NO CHANGE

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

x Yes o No

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

(Check One):

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

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

Yes o No x

The number of shares of the registrant s common stock outstanding as of July 9, 2007 was 44,928,105.

INNOVO GROUP INC.

QUARTERLY REPORT ON FORM 10-Q

PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

INNOVO GROUP INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands)

	May 26, 2007 (unaudited)	November 25, 2006
ASSETS		
Current assets		
Cash and cash equivalents	$ 337	$ 385
Accounts receivable, net of allowance for customer credits and returns of $2,081 (2007) and $469 (2006)	1,090	498
Inventories, net	11,311	6,267
Due from related parties	1,789	2,163
Prepaid expenses and other current assets	780	671
Total current assets	15,307	9,984
Property and equipment, net	745	837
Goodwill	20	20
Intangible assets, net	176	200
Other assets	9	56
Total assets	$ 16,257	$ 11,097
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities		
Accounts payable and accrued expenses	$ 7,050	$ 6,819
Due to factor	1,944	888
Due to related parties		82
Total current liabilities	8,994	7,789
Commitments and Contingencies		
Stockholders equity		
Preferred stock, $0.10 par value: 5,000 shares authorized, no shares issued or outstanding		
Common stock, $0.10 par value: 80,000 shares authorized, 41,390 shares issued and 41,178 outstanding (2007) and 34,455 shares issued and 34,343 outstanding (2006)	4,141	3,447
Additional paid-in capital	82,775	79,763
Accumulated deficit	(76,877)	(77,126)
Treasury stock, 112 shares	(2,776)	(2,776)
Total stockholders equity	7,263	3,308
Total liabilities and stockholders equity	$ 16,257	$ 11,097

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

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INNOVO GROUP INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

	Three months ended May 26, 2007 (unaudited)	May 27, 2006	Six months ended May 26, 2007 (unaudited)	May 27, 2006
Net sales	$ 15,171	$ 9,787	$ 28,985	$ 20,214
Cost of goods sold	7,822	6,556	16,541	15,163
Gross profit	7,349	3,231	12,444	5,051
Operating expenses				
Selling, general and administrative	6,605	5,494	11,587	11,228
Depreciation and amortization	87	63	175	122
	6,692	5,557	11,762	11,350
Income (loss) from continuing operations	657	(2,326)	682	(6,299)
Interest expense	(202)	(116)	(395)	(245)
Other income	(28)	(68)	(25)	(68)
Income (loss) from continuing operations, before taxes	427	(2,510)	262	(6,612)
Income taxes	5	7	13	15
Income (loss) from continuing operations	422	(2,517)	249	(6,627)
Loss from discontinued operations, net of tax		(2,461)		(2,043)
Net income (loss)	$ 422	$ (4,978)	$ 249	$ (8,670)
Earnings (loss) per common share - Basic				
Income (loss) from continuing operations	$ 0.01	$ (0.08)	$ 0.01	$ (0.20)
Loss from discontinued operations		(0.07)		(0.06)
Earnings (loss) per common share - Basic	$ 0.01	$ (0.15)	$ 0.01	$ (0.26)
Earnings (loss) per common share - Diluted				
Income (loss) from continuing operations	$ 0.01	$ (0.08)	$ 0.01	$ (0.20)
Loss from discontinued operations		(0.07)		(0.06)
Income (loss) per common share - Diluted	$ 0.01	$ (0.15)	$ 0.01	$ (0.26)
Weighted average shares outstanding				
Basic	41,227	33,428	40,334	33,365
Diluted	43,365	33,428	41,976	33,365

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

INNOVO GROUP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Six months ended May 26, 2007 (unaudited)	May 27, 2006
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash (used in) provided by continuing activities	$ (4,044)	$ 2,767
Cash provided by discontinued operations		601
Net cash (used in) provided by operating activities	(4,044)	3,368
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales of property and equipment	2	
Purchases of property and equipment	(61)	(148)
Net cash used in investing activities	(59)	(148)
Cash provided by discontinued operations		612
Net cash (used in) provided by investing activities	(59)	464
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from (payments on) factor borrowing, net	359	(2,630)
Proceeds from issuance of common stock	3,696	
Net cash provided by (used in) continuing activities	4,055	(2,630)
Cash used in discontinued operations		(1,242)
Net cash provided by (used in) financing activities	4,055	(3,872)
NET CHANGE IN CASH AND CASH EQUIVALENTS	(48)	(40)
CASH AND CASH EQUIVALENTS, at beginning of period	385	560
CASH AND CASH EQUIVALENTS, at end of period	$ 337	$ 520

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

INNOVO GROUP INC AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

(in thousands)

	Preferred Stock Shares	Preferred Stock Par Value	Common Stock Shares	Common Stock Par Value	Additional Paid-In Capital	Accumulated Deficit	Treasury Stock	Total Stockholders Equity
Balance, November 26, 2005		$	33,414	$ 3,343	$ 78,823	$ (67,833)	$ (2,776)	$ 11,557
Net loss						(8,670)		(8,670)
Stock-based compensation					1,022			1,022
Common stock issued to related party			1,041	104	(104)			
Balance, May 27, 2006 (unaudited)		$	34,455	$ 3,447	$ 79,741	$ (76,503)	$ (2,776)	$ 3,909
Balance, November 25, 2006		$	34,455	$ 3,447	$ 79,763	$ (77,126)	$ (2,776)	$ 3,308
Net income						249		249
Stock-based compensation					10			10
Issuance of common stock and warrants			6,934	694	3,002			3,696
Balance, May 26, 2007 (unaudited)		$	41,389	$ 4,141	$ 82,775	$ (76,877)	$ (2,776)	$ 7,262

INNOVO GROUP INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - BASIS OF PRESENTATION

The unaudited condensed consolidated financial statements of Innovo Group, Inc., or Innovo Group, which include the accounts of its wholly-owned subsidiaries, for the three and six months ended May 26, 2007 and May 27, 2006 and the related footnote information have been prepared on a basis consistent with Innovo Group s audited consolidated financial statements as of November 25, 2006 contained in Innovo Group s Annual Report on Form 10-K and Amendment No. 1 and Amendment No. 2 to its Annual Report on Form 10-K/A for the year ended November 25, 2006, or collectively, the Annual Report. Innovo Group s operating subsidiary includes Joe s Jeans Inc., or Joe s, and has historically included another entity, Innovo Azteca Apparel, Inc., or IAA. All significant inter-company transactions have been eliminated.

These unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the related notes thereto contained in Innovo Group s Annual Report. In the opinion of management, the accompanying unaudited financial statements contain all adjustments (consisting of normal recurring adjustments), which management considers necessary to present fairly Innovo Group s financial position, results of operations and cash flows for the interim periods presented. The results for the three and six months ended May 26, 2007 are not necessarily indicative of the results anticipated for the entire year ending November 24, 2007.

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements. Actual results may differ from those estimates. Innovo Group has only one segment of operations - apparel. Historically, Innovo Group operated in two segments - apparel and accessories. As a result of the sale of assets related to certain areas of its operations, Innovo Group has reclassified and reported the following operating divisions of its various subsidiaries as Discontinued Operations : (1) the craft and accessories division operated under its Innovo Inc. subsidiary, or Innovo, sold in May 2005; (2) the former headquarters in Springfield, Tennessee that were used as a commercial rental property operated under its Leaseall Management Inc. subsidiary, or Leaseall, sold in February 2006; and (3) the private label apparel division operated under its IAA subsidiary and sold in May 2006. Continuing operations include the results of Innovo Group s branded apparel business, including certain terminated branded apparel lines, which were not separate operating divisions and thus not considered to be part of Innovo Group s Discontinued Operations. Certain reclassifications have been made to prior year consolidated financial statements to conform to the current year presentation.

NOTE 2 SEASONALITY

The market for apparel products is seasonal. The majority of Innovo Group s marketing and sales activities take place from late fall to early spring and the greatest volume of shipments and sales occur from late spring through the summer. This time period coincides with Innovo Group s second and third fiscal quarters and its cash flow is generally strongest in its third and fourth fiscal quarters when a significant amount of its net sales are realized as a result of shipping orders taken during earlier months. In the second quarter, in order to prepare for peak sales, which occur during the second half of the year, Innovo Group builds its inventory levels, resulting in higher liquidity needs compared to other quarters. During this period, Innovo Group typically relies on its relationship with CIT Commercial Services, a unit of CIT Group, Inc., or CIT, for the sale of its account receivables and inventory advances to meet its cash flow requirements during the build up period proceeding the peak season. Innovo Group s working capital requirements during and in anticipation of its peak selling season require management to make and evaluate its estimates and judgments that affect its assets, liabilities, sales and expenses and any related contingencies.

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

NOTE 3 INVENTORIES

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

	May 26, 2007	November 25, 2006
Finished goods	$ 5,276	$ 5,026
Work in progress	2,221	468
Raw materials	4,264	1,292
	11,761	6,786
Less allowance for obsolescence and slow moving items	(450)	(519)
	$ 11,311	$ 6,267

Innovo Group recorded charges to its inventory reserve allowance of $196,600 and $0 for the three months ended May 26, 2007 and May 27, 2006, respectively and $196,600 and $996,000 for the six months ended May 26, 2007 and May 27, 2006, respectively.

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NOTE 4 RELATED PARTY TRANSACTIONS

As of May 26, 2007 and November 25, 2006, Innovo Group s related party balance consisted of amounts due from or due (to) certain related parties, as further described below, as follows:

	May 26, 2007	November 25, 2006
Commerce Investment Group and affliates	$ 1,787	$ 2,163
JD Holdings, Inc.	2	(82)
Due (to) from related parties, net	$ 1,789	$ 2,081

Commerce Investment Group and Affiliates

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

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

	Three months ended May 26, 2007	May 27, 2006	Six months ended May 26, 2007	May 27, 2006
Continuing operations				
Purchase order arrangements	$ 1,488	$ 1,534	$ 6,810	$ 1,950
Verbal facilities arrangement		90		227
Discontinued operations				
Supply agreement / Purchase order arrangements		7,163		16,642
Earn-out due to Sweet Sportswear		106		244
Verbal facilities agreement		121		302
Principal and interest on note payable		548		1,087

Continuing Operations - Purchase Order Arrangement

Innovo Group utilizes AZT as a supplier on a purchase order basis for certain of its Joe s® denim products. Under this arrangement, Innovo Group advances the funds to purchase raw materials, primarily fabric, anticipated for production of its products. Innovo Group pays AZT for the production cost less credit for the advances on raw materials. Innovo Group purchases these products from AZT in various stages of production from partial to completed finished goods.

Continuing Operations - Verbal Facilities Arrangement

Until mid-July 2006, Innovo Group utilized space for its headquarters and principal executive offices under a verbal month-to-month arrangement with Azteca. Under this arrangement, Innovo Group paid to Azteca a monthly fee for allocated expenses associated with its use of office and warehouse space, including a fee charged on a per unit basis for inventory and expenses in connection with maintaining such office and warehouse space. These allocated expenses included, but were not limited to, rent, security, office supplies, machine leases and utilities. In mid-July 2006, Innovo Group moved its headquarters and principal executive offices to nearby office and warehouse space, thereby terminating its obligation to pay Azteca under the verbal facilities arrangement.

Discontinued Operations   Supply Agreement/Purchase Order Arrangements

In July 2003, under an asset purchase agreement, or Blue Concept APA, with Azteca, Hubert Guez and Paul Guez, Innovo Group s IAA subsidiary acquired the Blue Concept Division of Azteca, a division which sells denim apparel primarily to American Eagle Outfitters, Inc., or AEO. Simultaneous with the Blue Concept APA, IAA entered into a non-exclusive Supply Agreement with AZT for the purchase of denim products to be sold to AEO, which expired on July 17, 2005. Under the terms of the Supply Agreement, AZT agreed that the purchase price on the products supplied would provide for a margin per unit of 15%. After the expiration of the supply agreement, Innovo Group continued to utilize AZT as a supplier on a purchase order basis for its AEO products under similar terms. Upon completion of the sale of IAA s private label division to Cygne Designs, Inc., or Cygne, as discussed in Note 5 Discontinued Operations, Cygne assumed $2,500,000 of the amount owed to AZT under this purchase order supply arrangement.

Discontinued Operations - Earn-out Due to Sweet Sportswear LLC

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

Discontinued Operations - Principal and Interest on Note Payable

Innovo Group had originally incurred long-term debt in connection with the purchase of the Blue Concept Division from Azteca. In July 2003, IAA issued a seven-year unsecured, convertible promissory note in the principal amount of $21.8 million, or the Blue Concept Note. The Blue Concept Note bore interest at a rate of 6% and required payment of interest only during the first 24 months and then was fully amortized over the remaining five-year period. On March 5, 2004, after stockholder approval, a portion of the Blue Concept Note was converted into 3,125,000 shares of common stock at a value per share of $4.00. Under the terms of the asset purchase agreement with Cygne, Cygne assumed the remaining principal balance of the Blue Concept Note. On May 12, 2006, pursuant to the closing of the transaction, Azteca released Innovo Group from any and all remaining obligations under the Blue Concept Note and it has been reclassified as a discontinued operation liability. Under the terms of the original asset purchase agreement, in addition to the shares previously issued, Innovo Group issued on May 17, 2006 an additional 1,041,667 shares of its common stock as a result of its average stock price trading at less than $3.00 per share for the period between February 10, 2006 and March 12, 2006. This share issuance has been recognized in the Statement of Stockholders Equity.

Discontinued Operations - Craft and accessories   Supply and Distribution Agreement

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

Aggregate balances by entities

As of May 26, 2007 and November 25, 2006, respectively, the balances due (to) or from these related parties and certain of their affiliates are as follows:

	May 26, 2007	November 25, 2006
AZT International SA de CV	$ 4,617	$ 4,994
Commerce Investment Group	(2,822)	(2,822)
Sweet Sportswear, LLC	(4)	(4)
Cygne Design Inc.	(4)	(5)
	$ 1,787	$ 2,163

The AZT balances represent the balances due as a result of Innovo Group s current production efforts in Mexico for our branded label apparel production. Upon completion of the sale of IAA s private label division to Cygne, as discussed in Note 5 Discontinued Operations, Cygne assumed the aggregate liability in the amount of $2,500,000 owed to Commerce and its affiliates. The balance due to Commerce represents the adjusted balance remaining that Innovo Group continues to be obligated for after the completion of the transaction with Cygne. The net balance of $4,000 due to Cygne represents the amount Innovo Group owes to Cygne as a result of certain chargebacks granted by Cygne on Innovo Group s behalf to former customers.

Joe s Jeans License

On February 7, 2001, Innovo Group acquired a license for the rights to the Joe s label from JD Design, LLC, or JD Design, along with the right to market the previously designed product line and existing sales orders, in exchange for 500,000 shares of Innovo Group s common stock and a warrant contingent on certain sales and gross margins which were not met and therefore, not eligible for exercise. In December 2006, JD Design transferred, through a merger, all of its assets to JD Holdings, Inc., or JD Holdings. For purposes of this Quarterly Report on Form 10-Q, any previous transactions with JD Design will utilize the name JD Holdings as its successor.

Additionally, Joe Dahan, the designer of the Joe s line and sole stockholder of JD Holdings, joined Innovo Group as President of its wholly owned subsidiary, Joe s Jeans, Inc. Under his employment agreement, Mr. Dahan received an option, with a four-year term, to purchase 250,008 shares of Innovo Group s common stock at $1.00 per share, vesting over 24 months. This option was exercised in full as of January 26, 2005. Under the terms of the license, Innovo Group is required to pay a royalty of 3% on net sales of its licensed products to JD Holdings. In October 2005, Innovo Group granted JD Holdings the right to develop the children s branded apparel line under an amendment to its master license agreement in exchange for a 5% royalty on net sales of those products. In addition, Innovo Group had a verbal arrangement to pay JD Holdings a design fee of 3% of net sales for assistance related to designs for its indie products, the line of business that Innovo Group exited in early 2006. See Note 13 JD Holdings Transaction for a further discussion about a subsequent transaction between Innovo Group and JD Holdings.

For the three and six months ended May 26, 2007 and May 27, 2006, the following table sets forth royalties, fees and income related to JD Holdings.

	Three months ended		Six months ended	
	May 26, 2007	May 27, 2006	May 26, 2007	May 27, 2006
Expense (income):				
Joe s Jeans royalty expense	$ 454	$ 261	$ 849	$ 563
indie Design fee		23		38
Children s license, royalty income	(9)	(11)	(36)	(26)

NOTE 5 DISCONTINUED OPERATIONS

Beginning in fiscal 2004, Innovo Group classified certain of its operations as discontinued as a result of such operations meeting certain accounting criteria of an asset held for sale. As a result, in fiscal 2004, its commercial rental property consisting of four separate buildings that served as its former headquarters located in Springfield, Tennessee and the remaining assets of its craft and accessory business segment conducted through its Innovo Inc. subsidiary were both first classified as discontinued operations. On May 17, 2005, Innovo Group s Innovo subsidiary completed the sale of the assets of its craft and accessory segment of operations. In February 2006, Innovo Group s Leaseall Management subsidiary completed the sale of each of the four separate buildings that served as its former headquarters for an aggregate sales price of $741,000 before net selling costs of approximately $126,000. Innovo Group also repaid the remaining note payable balance of $287,000 collateralized by a first deed of trust on these buildings with the proceeds from the sale. In connection with the sale of one of the buildings, Innovo Group received a promissory note issued by the purchaser in the original principal amount of $50,000, which represented a portion of the purchase price. As of May 26, 2007, $6,900 of the promissory note has been included on its balance sheet under Other current assets . The note bears interest at a rate of 8%, has a term of five years and is collateralized by a deed of trust on the building.

In January 2006, in connection with the Board of Directors decision to focus operations on its Joe s® brand, Innovo Group began to look for a purchaser for its private label apparel division operated by its IAA subsidiary that was originally purchased in July 2003 from Azteca. On May 12, 2006, Innovo Group completed the sale of its private label apparel division and accordingly, reported it as a discontinued operation. As such, all prior periods have been reclassified to reflect this operating division as a discontinued operation.

Under the asset purchase agreement for the private label division entered into with Cygne the assets sold included the private label division s customer list, the assumption of certain existing purchase orders and inventory related to the private label division, and the assumption of the benefit of a non-compete clause in favor of Azteca. In exchange for the purchased assets, Cygne assumed certain liabilities associated with the private label division, including, the remaining obligation under the original promissory note executed in favor of Azteca, all other liabilities, excluding the original promissory note, owed in connection with our operation of the private label division to Azteca in excess of $1,500,000, certain liabilities associated with outstanding purchase orders and inventory schedules listed in the asset purchase agreement, the obligation to continue to pay the earn-out under the original asset purchase agreement with Azteca and the liabilities related to the workforce of the private label division. The aggregate value of the assumed liabilities which represented the purchase price for the transaction was approximately $10,437,000 as of the closing date. Innovo Group also recorded an approximate charge of $36,000 for certain property and equipment disposed of or abandoned as part of discontinuing these operations. The following table sets forth a summary of the assumption of the liabilities in the transaction less the net book value of the private label assets and Innovo Group s resulting loss on the sale of these private label assets recorded during the second quarter of fiscal 2006 (in thousands):

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

In accordance with the provisions of SFAS No. 144 Accounting for the Impairment or Disposal of Long-Lived Assets, the accompanying consolidated financial statements reflect the results of operations and financial position of the commercial rental property, the craft and accessory business segment and the private label apparel division separately as a discontinued operation and in the related discussions and comparisons between current and prior fiscal years.

As of May 26, 2007 and November 25, 2006, respectively, there were no assets and liabilities of the discontinued operations that were presented in the consolidated balance sheets.

The following is a summary of loss and other information of the discontinued operations for the three and six months ended May 27, 2006. There was no loss and other information of the discontinued operations for the three and six months ended May 26, 2007.

	(in thousands) Private Label Business	**Innovo, Inc.**	**Leaseall Management**	**Total**
Three months ended May 27, 2006				
Net sales	$ 8,499	$	$	$ 8,499
Pre-tax income (loss) from operations	60	(4)	16	72
Loss on sale of assets	(2,533)			(2,533)
Income taxes				
Discontinued operations, net of tax	$ (2,473)	$ (4)	$ 16	$ (2,461)
Six months ended May 27, 2006				
Net sales	$ 20,001	$	$	$ 20,001
Pre-tax income (loss) from operations	512	(4)	(34)	474
Loss on sale of assets	(2,533)		16	(2,517)
Income taxes				
Discontinued operations, net of tax	$ (2,021)	$ (4)	$ (18)	$ (2,043)

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

NOTE 6 ACCOUNTS RECEIVABLE, INVENTORY ADVANCES AND DUE (TO) FACTOR

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

	May 26, 2007	November 25, 2006
Non-recourse receivables assigned to factor	$ 6,232	$ 7,354
Recourse receivables assigned to factor	350	2,717
Total receivables assigned to factor	6,582	10,071
Allowance for customer credits and doubtful accounts	(784)	(821)
Net advances from factor	(7,742)	(10,138)
Due to factor	$ (1,944)	$ (888)
Non-factored accounts receivable	3,171	967
Allowance for customer credits and doubtful accounts	(2,081)	(469)
Accounts receivable and due from factor, net of allowance	$ 1,090	$ 498

As of May 26, 2007 and November 25, 2006, there were $350,000 and $2,717,000, respectively, of client recourse receivables, including advances under its inventory security agreement, sold to or advanced by factor. Innovo Group bears the risk of payment in the event of non-payment by the customers for the client recourse receivables sold to factor.

CIT Commercial Services

On June 1, 2001, Innovo Group s Innovo and Joe s subsidiaries, and on September 10, 2001, its IAA subsidiary, entered into accounts receivable factoring agreements with CIT. Subsequent to these agreements, the subsidiaries also entered into inventory security agreements, collectively with the factoring agreements referred to as the Factoring Facilities. These Factoring Facilities give Innovo Group the ability to obtain cash by selling to CIT certain of its accounts receivable for up to 85% of the face amount of the receivables, on either a recourse or non-recourse basis depending on the creditworthiness of the customer. The Factoring Facilities also allow Innovo Group to obtain advances for up to 50% of the value of certain eligible inventory. Innovo Group currently obtains funds under the Factoring Facilities at 85% of factored invoices and under the inventory security agreement up to approximately $2,700,000 of maximum availability. CIT has the ability, in its discretion at any time or from time to time, to adjust or revise any limits on the amount of loans or advances made to Innovo Group pursuant to the Factoring Facilities. As further assurance to enter into the Factoring Facilities, cross guarantees were executed by and among Innovo Group, Innovo, Joe s and IAA, to guarantee each subsidiaries obligations and in November 2004, upon request by CIT, Innovo Group s Chairman, Sam Furrow, executed a personal guarantee for up to $1,000,000. This personal guarantee by Mr. Furrow has contributed to Innovo Group s ability to obtain cash under its existing Factoring Facilities. In addition, in October 2006, JD Holdings granted to CIT a security interest in the Joe s® trademarks and executed a non-recourse guaranty in favor of CIT to allow Innovo Group to obtain additional advances under its inventory security agreement. In connection with this security interest and guaranty, Innovo Group entered into an agreement with JD Holdings to provide protection to JD Holdings through the potential issuance of a maximum of 6,834,347 shares of its common stock as collateral for the non-recourse guaranty and security interest granted to CIT.

As of May 26, 2007, Innovo Group s availability with CIT was approximately $290,000 under the Factoring Facilities. This amount fluctuates on a daily basis based upon invoicing and collection related activity by CIT for the receivables sold. In connection with the agreements with CIT, certain assets are pledged to CIT, including all of the inventory, merchandise, and/or goods, including raw materials through finished goods and receivables. With the sale and cessation of operations for certain divisions and business lines, Innovo Group is primarily utilizing the Factoring Facilities of its Joe s Jeans subsidiary; however, certain of its other subsidiary Factoring Facilities have limited activity.

These Factoring Facilities may be terminated by CIT upon 60 days prior written notice or immediately upon the occurrence of an event of default, as defined in the agreement. The agreements automatically renew for one year periods and may be terminated by Innovo Group or its subsidiaries, upon 60 days advanced written notice prior to June 30, 2008 or earlier provided that the minimum factoring fees have been paid for the respective period.

The factoring rate that Innovo Group pays to CIT to factor accounts is at 0.6% for accounts which CIT bears the credit risk and 0.4% for accounts which Innovo Group bears the credit risk and the interest rate associated with borrowings under the inventory lines and factoring facility is at 0.25% plus the Chase prime rate. As of May 26, 2007, the Chase prime rate was 8.25%.

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

NOTE 7 EARNINGS PER SHARE

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

	Three months ended (in thousands, except per share data)		Six months ended (in thousands, except per share data)	
	May 26, 2007	**May 27, 2006**	**May 26, 2007**	**May 27, 2006**
Basic Earnings per share Computation:				
Numerator:				
Income (loss) from continuing operations	$ 422	$ (2,517)	$ 249	$ (6,627)
Loss from discontinued operations		(2,461)		(2,043)
Net income (loss)	$ 422	$ (4,978)	$ 249	$ (8,670)
Denominator:				
Weighted average common shares outstanding	41,227	33,428	40,334	33,365
Income (loss) per Common Share - Basic				
Income (loss) from continuing operations	$ 0.01	$ (0.08)	$ 0.01	$ (0.20)
Loss from discontinued operations		(0.07)		(0.06)
Net income (loss)	$ 0.01	$ (0.15)	$ 0.01	$ (0.26)
Diluted Earnings per share Computation:				
Numerator:				
Income (loss) from continuing operations	$ 422	$ (2,517)	$ 249	$ (6,627)
Loss from discontinued operations		(2,461)		(2,043)
Net income (loss)	$ 422	$ (4,978)	$ 249	$ (8,670)
Denominator:				
Weighted average common shares outstanding	41,227	33,428	40,334	33,365
Effect of dilutive securities:				
Options and warrants	2,138		1,642	
Dilutive potential common shares	43,365	33,428	41,976	33,365
Income (loss) per Common Share - Dilutive				
Income (loss) from continuing operations	$ 0.01	$ (0.08)	$ 0.01	$ (0.20)
Loss from discontinued operations		(0.07)		(0.06)
Net income (loss)	$ 0.01	$ (0.15)	$ 0.01	$ (0.26)

Potentially dilutive convertible notes, options and warrants in the aggregate of 5,091,463 as of May 27, 2006 have been excluded from the calculation of the diluted loss per share as their effect would have been anti-dilutive. There were no potentially dilutive notes, option and warrants as of May 26, 2007.

NOTE 8 INCOME TAXES

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

Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected more likely than not to be realized. The likelihood of a material change in Innovo Group s expected realization of these assets depends on our ability to generate sufficient future taxable income. Innovo Group s ability to generate sufficient taxable income to utilize its deferred tax assets depends on many factors, among which is its ability to deduct tax loss carry-forwards against future taxable income, the effectiveness of the Company s tax planning strategies and reversing deferred tax liabilities.

In June 2006, the FASB issued FASB Interpretation No. 48 Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement 109, or FIN 48. FIN 48 establishes a single model to address accounting for uncertain tax positions. FIN 48 clarifies the accounting for income taxes by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. Innovo Group expects to adopt the provisions of FIN 48 on November 25, 2007. Upon adoption, Innovo Group does not expect any adjustment in the amount of unrecognized tax benefits. Innovo Group s policy is to recognize interest and penalties that would be assessed in relation to the settlement value of unrecognized tax benefits as a component of income tax expense.

Innovo Group and its subsidiaries are subject to U.S. federal income tax as well as income tax in multiple state jurisdictions. With few exceptions, Innovo Group is no longer subject to U.S. federal income tax examinations for years before 2003; and state and local income tax examinations before 2002. However, to the extent allowed by law, the tax authorities may have the right to examine prior periods where net operating losses were generated and carried forward, and make adjustments up to the amount of the net operating loss carryforward amount.

Innovo Group is not currently under tax examination by the Internal Revenue Service (IRS) or any state, local or foreign jurisdictions.

As of November 25, 2006, Innovo Group had federal net operating loss, or NOL, carryforwards of approximately $61.2 million. The federal tax net operating loss carryforwards represent a significant component of Innovo Group s deferred tax assets. Due to uncertainties surrounding Innovo Group s ability to generate sufficient future taxable income to realize these assets, a full valuation has been established to offset its net deferred tax asset. Additionally, the future utilization of Innovo Group s NOL carryforwards to offset future taxable income may be subject to a substantial annual limitation as a result of ownership changes. Any carryforwards that will expire prior to utilization as a result of such limitations will be removed from deferred tax assets with a corresponding reduction of the valuation allowance.

NOTE 9 STOCKHOLDERS EQUITY

Recent Issuances of Common Stock

In December 2006, Innovo Group issued 6,834,347 shares of its common stock at a purchase price of $0.53 per share, two warrants to purchase up to 2,050,304 shares of common stock each with an exercise price of $0.58 per share and one warrant to purchase up to 125,000 shares of common stock with an exercise price of $0.66 per share in a private placement transaction. See Note 11- Private Placement Transaction for a further discussion of this equity financing transaction.

On June 27, 2007, Innovo Group entered into another private placement transaction. In July 2007, Innovo Group issued 1,600,000 shares of its common stock at a purchase price of $1.25 per shares and two warrants to purchase up to 480,000 shares of its common stock with an exercise price of $1.36 per share. See Note 11- Private Placement Transaction for a further discussion of this equity financing transaction.

On June 27, 2007, Innovo Group received notices from two holders of warrants that it was exercising certain previously issued warrants. As a result, subsequent to the quarter end, Innovo Group issued 2,050,304 shares of its common stock and received gross proceeds of $1,189,176 in connection with the warrant exercise.

Warrants

Innovo Group has issued warrants in conjunction with various private placements of its common stock, debt to equity conversions, acquisitions and in exchange for services. In December 2006, in connection with the equity financing private placement transaction, Innovo Group issued two warrants to purchase up to 2,050,304 common stock each with an exercise price of $0.58 per share and one warrant to purchase up to 125,000 shares of common stock with an exercise price of $0.66 per share. In June 2007, Innovo Group issued two warrants to purchase up to 480,000 shares of its common stock with an exercise price of $1.36 per share. See Note 11- Private Placement Transaction for a further discussion of this equity financing transaction. Except for the warrants issued in the June 2007 private placement transaction, all warrants are currently exercisable. As of May 26, 2007, outstanding common stock warrants are as follows:

Exercise price		Shares	Issued	Expiration
$	4.50	200,000	June 2003	June 2008
	3.62	17,500	August 2003	August 2008
	4.00	373,333	November 2003	November 2008
	1.53	125,000	June 2004	June 2009
	2.28	62,500	October 2004	October 2009
	0.58	2,050,304	December 2006	December 2011
	0.66	125,000	December 2006	December 2011
		2,953,637		

Stock Option Plans

In March 2000, Innovo Group adopted the 2000 Employee Stock Option Plan, or the 2000 Employee Plan. In May 2003, the 2000 Employee Plan was amended to provide for incentive and nonqualified options for up to 3,000,000 shares, subject to adjustment, of common stock that may be granted to employees, officers, directors and consultants. On June 3, 2004, in connection with stockholder approval of the 2004 Stock Incentive Plan, Innovo Group stated that it would no longer grant options pursuant to the 2000 Employee Plan, however, the 2000 Employee Plan remains in effect for awards outstanding as of June 3, 2004. The exercise price for incentive options may not be less than the fair market value of Innovo Group s common stock on the date of grant and the exercise period may not exceed ten years. Vesting periods and option terms are determined by the Board of Directors. On May 12, 2006, 1,050,000 options were forfeited by employees under the 2000 Employee Plan. As of May 26, 2007, options to purchase up to 200,000 remained outstanding under the 2000 Employee Plan. These options will expire, if unexercised, on December 11, 2007.

In September 2000, Innovo Group adopted the 2000 Director Stock Incentive Plan, or the 2000 Director Plan, under which nonqualified options for up to 500,000 shares of common stock may be granted. At the first annual meeting of stockholders following appointment to the board and annually thereafter during their term, each non-employee director received an option to purchase common stock with an aggregate fair value of $10,000. These options vested on a monthly basis and were generally exercisable in full one year from the date of grant and expire ten years after the date of grant. The exercise price was set at 50% of the fair market value of the common stock on the date of grant. The discount was in lieu of cash director fees. On June 3, 2004, in connection with stockholder approval of the 2004 Stock Incentive Plan, Innovo Group stated that it would no longer grant options pursuant to the 2000 Director Plan; however, the 2000 Director Plan remains in effect for awards outstanding as of June 3, 2004. As of May 26, 2007, options to purchase up to 203,546 remained outstanding under the 2000 Director Plan. These options expire, if unexercised, on dates ranging from 2010 to 2013.

On June 3, 2004, Innovo Group s stockholders adopted the 2004 Stock Incentive Plan, or the 2004 Incentive Plan, and on June 9, 2005, Innovo Group s stockholders amended it to increase the number of shares authorized for issuance to 4,265,172 shares of common stock. Under the 2004 Incentive Plan, grants may be made to employees, officers, directors and consultants. The 2004 Incentive Plan limits the number of shares that can be granted to any employee in one year to 1,250,000. Exercise price for incentive options may not be less than the fair market value of Innovo Group s common stock on the date of grant and the exercise period may not exceed ten years. Vesting periods and option terms are determined by the Board of Directors and/or its Compensation and Stock Option Committee, or Compensation Committee. The 2004 Incentive Plan includes a provision for the acceleration of vesting of stock options upon a change of control of Innovo Group as well as a provision that allows forfeited or unexercised options that have expired to be available again for future issuance. During the second quarter of fiscal 2006, Innovo Group granted options to purchase up to 1,500,000 shares of its common stock to its directors and employees pursuant to the 2004 Stock Incentive Plan. In May 2006, Innovo Group s Compensation Committee of its Board of Directors approved a direct amendment under the terms of the 2004 Stock Incentive Plan to reduce the exercise price for certain previously granted options for certain participants to $1.02, which was the closing price on May 12, 2006. In addition, two employees forfeited previous option grants to purchase 1,050,000 shares of common stock pursuant to the 2000 Employee Stock Incentive Plan in exchange for a grant of new options pursuant to the 2004 Stock Incentive Plan. As of May 26, 2007, 477,256 shares remain available for issuance under the 2004 Incentive Plan.

The shares of common stock issued upon exercise of a previously granted stock option are considered new issuances from shares reserved for issuance in connection with the adoption of the various plans. Innovo Group requires that the option holder provide a written notice of exercise in accordance with the option agreement and plan to the stock plan administrator and full payment for the shares be made prior to issuance. All issuances are made under the terms and conditions set forth in the applicable plan.

The following summarizes option grants to members of the Board of Directors for the fiscal years 2002 through second quarter of 2007 (in actual amounts):

May 26, 2007
Number of