INNOVO GROUP INC
Form 10-K/A
February 09, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Amendment No. 1 to

FORM 10-K

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES

EXCHANGE ACT OF 1934

For the fiscal year ended November 25, 2006

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, including zip code)

Registrant s telephone number, including area code: **(323) 837-3700**

Securities registered pursuant to Section 12 (b) of the Act:
Common Stock, $0.10 par value
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No x

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. Yes x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not 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-K or any amendment to this Form 10-K. o

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.)

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 Act.) Yes o No x

The aggregate market value of the voting and non-voting common stock held by non-affiliates of the registrant based on the closing price of the registrant s common stock on The Nasdaq Stock Market, Inc. as of May 26, 2006, was approximately $19,254,000.

The number of shares of the registrant s common stock outstanding as of February 8, 2006 was 41,177,801.

Documents incorporated by reference: Portions of the registrant s definitive proxy statement to be filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year are incorporated by reference in Part III of this Annual Report on Form 10-K.

Explanatory Note

This Amendment No. 1 on Form 10-K/A is being filed by Innovo Group Inc. to amend our Annual Report on Form 10-K for the fiscal year ended November 25, 2006 filed with the Securities and Exchange Commission on February 8, 2007, or the Initial Report. This Amendment No. 1 is being filed for the sole purpose of correcting a typographical error on our Consolidated Statement of Cash Flows on the Accounts Receivable line for the year ended November 26, 2005.

Our Consolidated Statement of Cash Flows in the Initial Report inadvertently reported the Changes in operating assets and liabilities: Accounts receivable for the year ended November 26, 2005 as the number 263 instead of the correct number 2,631 for such period.

This report speaks as of the original filing date, and except as indicated, has not been updated to reflect events occurring subsequent to the original filing date.

INNOVO GROUP INC.

FORM 10-K ANNUAL REPORT

FOR THE FISCAL YEAR ENDED NOVEMBER 25, 2006

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PART I

Forward-Looking Statements

Statements contained in this Annual Report on Form 10-K, or Annual Report, and in future filings with the Securities and Exchange Commission, or the SEC, in our press releases or in our other public or shareholder communications that are not purely historical facts are forward-looking statements. Statements looking forward in time are included in this Annual Report pursuant to the safe harbor provision of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements include, without limitation, any statement that may predict, forecast, indicate, or imply future results, performance, or achievements, and may contain the words, believe , anticipate , expect , estimate , inte plan , project , will be , will continue , will likely result , and any variations of such words with similar meanings. These statements are not guarantees of future performance and are subject to certain risks and uncertainties that are difficult to predict; therefore, actual results may differ materially from those expressed or forecasted in any such forward-looking statements.

Factors that would cause or contribute to such differences include, but are not limited to, the risk factors contained or referenced under the headings Business, Risk Factors and Management s Discussion and Analysis of Financial Condition and Results of Operations set forth in this Annual Report. In particular, certain risks and uncertainties that we face include, but are not limited to, risks associated with:

- our ability and success in implementing our strategic plan to focus our resources on our Joe s® brand;
- our ability to operate profitably and effectively manage expenses;
- our ability to execute and successfully implement a proposed merger with JD Holdings Inc., the successor-in-interest to JD Design LLC from whom we have our Joe s® license;
- our ability to maintain requirements to list our common stock on Nasdaq;
- our reliance on our Joe s® brand to generate revenue; and
- our ability to maintain and effectively manage relationships with vendors and third parties to whom we outsource certain of our business operations.

Since we operate in a rapidly changing environment, new risk factors can arise and it is not possible for our management to predict all such risk factors, nor can it assess the impact of all such risk factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. Given these risks and uncertainties, readers are cautioned not to place undue reliance on forward-looking statements that only speak as of the date of this filing.

We undertake no obligation to publicly revise these forward-looking statements to reflect events, circumstances or the occurrence of unanticipated events that occur subsequent to the date of this Annual Report. As used in this Annual Report, the terms we , us , our , and Innovo Group refer to Innovo Group Inc. and our subsidiaries and affiliates, unless the context indicates otherwise.

ITEM 1. BUSINESS

Overview

We began our operations in April 1987 as Innovo, Inc., or Innovo, a Texas corporation, to manufacture and domestically distribute cut and sewn canvas and nylon consumer products for the utility, craft, sports licensed and advertising specialty markets. In 1990, Innovo merged into Elorac Corporation, a Delaware corporation, and renamed itself our present name, Innovo Group Inc. Initially, we produced craft and accessory products for the consumer marketplace through various operating subsidiaries. Since that time, we gradually evolved from producing craft and accessory products to designing and selling apparel products. During this transition, we moved our operations from Tennessee to Los Angeles, California.

Our principal business activity has evolved into the design, development and worldwide marketing of apparel products, primarily, denim jeans and related casualwear. Our primary apparel products bear the brand name Joe s® operated under our Joe s Jeans Inc., or Joe s Jeans, subsidiary. Since Joe s Jeans was established in 2001, the brand is recognized in the premium denim industry for its quality, fit and fashion-forward designs. Because we focus on design, development and marketing, we rely on third party manufacturers to manufacture our apparel products for distribution and Pixior LLC, or Pixior, a Los Angeles-based distribution company, for product fulfillment services. We sell our products to numerous retailers, which include major department stores, specialty stores, and distributors around the world.

Fiscal 2006 was a transition year for us. After deciding to focus our operations on our Joe s® brand, we decided to cease operations of our other branded and private label business. In May 2006, we sold certain of the assets related to our private label division where we made denim apparel products for mass market retailers such as American Eagle Outfitters Inc., or AEO, and Target Corporation, or Target. In addition throughout the course of the fiscal year, we ceased production and sold the remaining indie and Betsey Johnson® inventory to focus on our Joe s® business. Further, in the third quarter of fiscal 2006, we began operating under an agreement with Pixior to outsource our product fulfillment services, including our warehousing, distribution and customer services needs for our products and moved our principal offices to space under a verbal facilities arrangement with Pixior.

To enhance our ability to capitalize on the Joe s® brand, on February 6, 2007, we entered into a merger agreement to merge with JD Holdings Inc., or JD Holdings, the successor in interest to JD Design LLC, or JD Design, the entity from whom we license the Joe s® brand. In exchange for all of the rights to the Joe s® brand and subject to approval by our stockholders, we will issue to JD Holdings 14,000,000 shares of our common stock, $300,000 in cash and enter into an employment agreement with Joe Dahan, the principal designer of the Joe s brand and sole stockholder of JD Holdings. In the event that the merger is approved, the license agreement will terminate and we will own all right, title and interest in the Joe s® brand and marks. By owning all rights to the Joe s® brand and marks outright, we will eliminate any risks associated with the potential termination of the license agreement and have the right to control the direction of the brand and our company, including licensing opportunities. To capitalize on licensing opportunities for the brand, we also announced that we entered into a license agreement with the Betesh Group to be effective upon completion of the merger agreement for the worldwide license to produce and sell handbags, belts and small leather goods, such as wallets for men and women bearing the Joe s® brand. We will receive a royalty of 10% on net sales of these products subject to certain minimums. The initial term of the license after it becomes effective will be through December 31, 2010 with certain renewal rights.

Principal Products and Revenue Sources

Our principal apparel products bear the Joe s® mark and operate under our Joe s Jeans subsidiary. Historically, our principal products also included private label denim and denim-related apparel products and other branded denim and denim-related apparel products bearing the indie , Betsey Johnson®, Fetish and Shago® marks operated under our Innovo Azteca Apparel, Inc., or IAA, subsidiary. Since the sale in May 2006 of certain assets of our private label business and subsequent classification as a discontinued operation, our continuing operations for fiscal 2006 only include net sales of our Joe s® brand and net sales of other terminated branded apparel lines. Because these other branded apparel lines were not separate operating divisions, the terminated lines are not included as part of our discontinued operations. They continue to be reflected in our overall net sales even though the brands will not be part of our continuing operations for fiscal 2007. We also sold the assets of our craft and accessory business operated under our Innovo subsidiary in May 2005 and reported that subsidiary as a discontinued operation as of fiscal 2004. For the previous three fiscal years, our net sales from continuing operations are as follows:

	(in thousands) **2006**	**2005**	**2004**
Joe s Jeans	$ 45,264	$ 33,304	$ 18,296
Other Branded	1,369	2,616	8,420
Total	$ 46,633	$ 35,920	$ 26,716

Joe s®

Through fiscal 2006 from fiscal 2004, our Joe s® brand represented approximately 97%, 93% and 68%, respectively, of our total net sales from continuing operations. This increase in percentage of overall net sales attributable to our Joe s® brand is indicative of our transition and decision to focus our resources on it and the reclassification of certain operations as discontinued.

Our Joe s® product line includes women s, men s and children s denim jeans, pants, shirts, sweaters, jackets and other apparel products sold domestically and internationally. Joe s® products are marketed to U.S. retailers through third party showrooms located in New York and Los Angeles and to international retailers through international distributors with showrooms in Paris, Tokyo and Germany. Joe s ® women s product line represents our largest source of revenue and consists primarily of denim jeans in a variety of different fits, fabrics, washes and detailing. Every season, we continue to offer certain core basic styles in addition to new ones to appeal to trendsetters and fashion forward consumers. We believe our attention to fitting different body styles gives us an advantage in the marketplace, as we can offer the consumer a product designed and tailored to fit her needs. We have branded the different fit styles so that the consumer can differentiate and choose from the variety carried by the retailer. Our fit styles currently include:

- Chelsea an ultra slim fit;
- Cigarette a straight and narrow fit;
- Honey a curvy fit;
- Lover a relaxed fit;
- Muse a higher waist fit;
- Provocateur a petite fit with a shorter inseam;
- Rocker a lean flare fit;
- Socialite a classic bootcut fit;

- Starlet a slim legged bootcut fit; and
- Twiggy a taller fit with a longer inseam.

Joe s® women s product offerings also include non-denim pants, denim skirts, denim and leather jackets, knit shirts, and sweaters. Suggested retail prices for Joe s® women s products currently range from $143 to $174 for denim and fashion pants, from $88 to $198 for tops and from $215 to $450 for jackets.

In the first quarter of fiscal 2006, Joe s® expanded its offerings by re-launching its men s denim line. Joe s® men s product line consists of men s denim jeans, in addition to non-denim pants, knit shirts, sweaters, and denim and leather jackets. We have carried over the concept from our women s line of offering a variety of different fits, fabrics, washes and detailing in our product selection. Similar to women s, we also offer for men certain core basic styles every season in addition to new styles. We also brand the fit styles, which include the Brixton, the Classic, the Rebel and the Rocker. Suggested retail prices for Joe s® men s products range currently from $158 to $289 for denim and fashion pants, from $62 to $168 for tops and from $158 to $795 for jackets.

Children s product offerings bearing the Joe s® brand first began selling in the first quarter of fiscal 2006 and include boy s, girl s and toddler s denim jeans and a limited selection of non-denim pants, tops and jackets. We do not participate in nor are we responsible for the product designs, manufacturing or sales of the children s products because we amended our master license agreement to release back these rights to JD Design. In exchange for this release, we receive royalty income of 5% on the net sales of the children s products. The royalty income received is included in our net sales.

Other Branded Apparel

Beginning in fiscal 2004, we terminated several of our branded apparel license agreements. In fiscal 2004, we terminated our license agreements for Fetish , Shago® and Hot Wheels® branded apparel. In July 2005, we terminated the license agreement associated with the Betsey Johnson® brand and in January 2006, we decided to exit the operation of our indie branded apparel line. During fiscal 2006, we had limited sales of other branded apparel bearing the indie and Betsey Johnson® marks. These sales related primarily to the liquidation of remaining inventory.

Private Label Apparel

From fiscal 2003 until May 2006, we also designed and developed private label apparel products under purchase order arrangements for mass market retailers. Our private label product line consisted of denim jeans for both the men s and women s market. Through private label arrangements, we sold denim products primarily to AEO and Target. In May 2006, we sold the assets of this division to Cygne Designs Inc., or Cygne, and now report this division as a discontinued operation. See Notes to Consolidated Financial Statements - Note 3 - Discontinued Operations for further discussion of the sale of these assets.

Product Design, Development and Sourcing

Joe s®

Our product development for the Joe s® brand is managed internally by a team of designers led by Joe Dahan, the owner of JD Design and president of our Joe s Jeans subsidiary. This design team is responsible for the creation, development and coordination of the product group offerings within each collection. Joe s® typically develops four collections per year for spring, summer, fall and holiday, with certain core basic styles offered throughout the year. Joe Dahan is an instrumental part of Joe s® design process. When we originally licensed the Joe s® brand from JD Design, we also entered into an employment agreement with Joe Dahan. The loss of Joe Dahan could have a material adverse impact on us; however, we believe we could find alternative sources for the development and design of Joe s products. The termination of employment of Joe Dahan would not affect our license agreement for the Joe s® brand. Furthermore, in connection with the proposed merger agreement, we have agreed to enter into a ten year employment contract with Joe Dahan for his services as the Creative Director of the brand to be effective as of the closing of the merger. While his current and proposed employment agreement both contain customary provisions related to continued employment, we believe that should Mr. Dahan s employment terminate, we would be able to find alternative sources for the development and design of Joe s® products. See Risk Factors The loss of the services of key personnel could have a material adverse effect on our business.

We currently rely on third party manufacturers to manufacture all of our products for distribution. Our manufacturers are primarily located in Mexico and the United States. For production in Mexico, we utilize an existing manufacturing relationship with a related party for the manufacture of our products. We purchase these products in various stages of production from partial to completed finished goods. We control the production schedules in order to ensure quality and timely deliveries. We outsource the warehousing, picking, packing and shipping of our Joe s® products to retailers to Pixior under an outsourcing agreement. We also share facilities with Pixior under a verbal lease arrangement. We purchase fabric for Joe s products both domestically and internationally from independent vendors. Our raw materials are principally blends of fabrics, yarns and threads and are available from multiple sources. We have not experienced any material shortage of raw material for our needs.

We continue to explore alternate inventory strategies designed to improve our gross margins. However, there can be no assurance that any change in sourcing will result in enhanced profit margins, similar quality or timely deliveries, but we do believe that continuing to monitor this expense can be beneficial for growth of our Joe s brand.

Other Branded Apparel

For other branded apparel lines that we no longer produce, we developed those products internally or in conjunction with design personnel of the licensor. Our Betsey Johnson® products were sourced from domestic contractors generally located in the Los Angeles area and our indie products were sourced from Mexico generally through Azteca Production International, Inc., or Azteca. Since we had not yet begun operating under our arrangement with Pixior, we were responsible for warehousing, packing and shipping our products to a warehouse which we previously shared under a verbal arrangement with Azteca and its affiliates for distribution directly to the retailer. We purchased fabric for these apparel lines both domestically and internationally from independent vendors.

General Product Sourcing

Historically, we relied on two of our stockholders, Hubert Guez and Paul Guez and their affiliated companies, including, Azteca and Commerce Investment Group LLC, or Commerce, for their experience and ability to source and supply our products. Initially, to assist with our transition from a craft and accessory business to the denim apparel and design business, we developed a strategic relationship with Hubert Guez and Paul Guez, Azteca and Commerce. Beginning in the summer of 2000, we entered into a series of transactions with them, including the issuance of securities, the execution of supply, manufacturing, warehousing and distribution agreements, and the acquisition of certain of their existing business units. The Guez brothers and their affiliated companies have in the aggregate more than fifty years of experience in the apparel industry with a specialty in denim apparel and related products.

While we have begun to reduce our reliance on our strategic relationship with the Guez s through the transitions of fiscal 2006, we currently utilize an Azteca subsidiary located in Mexico, AZT International SA de CV, or AZT, and its ability to manufacture our products on a purchase order basis. We purchase our products from them in various stages of production from partial to completed finished goods. We do not have a long-term supply agreement with them or any third party contractors, but we believe that there are a number of overseas and domestic contractors that could fulfill our requirements in the event that AZT would not be able to do so. Under our purchase order supply arrangement with AZT, during fiscal 2006, we purchased from AZT and its affiliates, approximately $12,845,000 or 55% of our products compared to $2,560,000, or 8%, in fiscal 2005, excluding products for our private label apparel division that we sold in May 2006 and report as a discontinued operation.

In the event we terminate our relationship with AZT in Mexico or the economic climate or other factors result in a significant reduction in the number of local contractors in the Los Angeles area, our business could be negatively impacted. At this time, we believe that we would be able to find alternative sources for the production of our apparel products if this were to occur; however, no assurances can be given that a transition could be completed without a short or long term disruption to our business.

We generally purchase our products in U.S. dollars. However, because we use some overseas or non-U.S. suppliers, the cost of these products may be affected by changes in the value of the relevant currencies. Certain of our apparel purchases in the international markets will be subject to the risks associated with the importation of these type products. See Business-Import Restrictions and Other Governmental Regulations.

While we attempt to mitigate our exposure to manufacturing risk, the use of independent contractors does reduce our control over production and delivery and exposes us to the usual risks of sourcing products from independent suppliers. Transactions with our foreign manufacturers and suppliers are subject to the typical risks of doing business abroad, generally, such as the cost of transportation and the imposition of import duties and restrictions. The United States and the countries in which our products are manufactured may, from time to time, impose new quotas, duties, tariffs or other restrictions, or adjust presently prevailing quotas, duty or tariff levels, which could affect our operations and our ability to import products at current or increased levels. We cannot predict the likelihood or frequency of any such events occurring. See Business - Import Restrictions and Other Governmental Regulations.

License Agreements and Trademarks

Joe s® License Agreement

In February 2001, we acquired license rights to the JD stylized logo and the Joe s® mark for most apparel and accessory products from JD Design. The license agreement has a ten-year term with two ten-year renewal periods subject to us not being in material default at the end of each period. Additionally, pursuant to the terms of the agreement, Joe Dahan receives a 3% royalty on the net sales of Joe s® products. We believe that we will be able to renew our Joe s® license; however, there can be no assurance that other factors may arise that could result in the non-renewal of this license.

On February 6, 2007, we entered into a merger agreement with JD Holdings, the successor-in-interest to JD Design, to acquire all right, title and interest in the Joe s® brand and related marks. In exchange for the rights to the Joe s® brand and subject to approval by our stockholders, we will issue to JD Holdings 14,000,000 shares of our common stock, $300,000 in cash and enter into an employment agreement with Joe Dahan, the principal designer of the Joe s brand and sole stockholder of JD Holdings. In the event that the merger is approved, the license agreement will terminate and we will own all right, title and interest in the Joe s® brand and the marks. By owning all rights to the Joe s® brand and marks outright, we will eliminate any risks associated with the potential termination of the license agreement and have the right to control the direction of the brand and our company. In addition, we also entered into a license agreement to be effective after completion of the merger agreement for the worldwide license for bags, belts and small leather goods, such as wallets for a royalty on the net sales. We expect that in the event the merger is approved and completed, we will seek additional license partners for the Joe s® brand.

As the licensee and on behalf of JD Design, we have applied for protection with the United States Patent and Trademark Office, as well as with various foreign jurisdictions, such as Australia, Canada, China, the European Union, Japan, Korea, India, New Zealand, Russian Federation, Singapore, Switzerland and Turkey for trademark protection for certain of Joe s logos and Joe s Jeans marks for apparel and accessory products. As of November 25, 2006, three trademark registrations for various stylized designs bearing variations of Joe s, Joe s Jeans and JD name and or logo have been issued, one has been allowed and one trademark registration for the Lover has been issued in the United States. Internationally, primarily under the Madrid Protocol, 38 trademark registrations have been issued and we continue to prosecute 22 pending trademark applications internationally that we believe are necessary to protect the brand.

Terminated Branded Apparel Lines

As we evaluated our business operations during fiscal 2004 through fiscal 2006, we terminated the operation of several of our branded apparel lines. A discussion of these branded apparel license agreements and rights is included to provide the reader with background information about these terminated branded apparel lines.

indie

In June 2004, we announced the launch and initial development of a new line of company-owned and designed branded denim and denim-related apparel bearing the brand name indie . The indie line was a collection of women s five-pocket denim jeans and skirts, tops and jackets utilizing our in-house denim design, production and marketing personnel. indie products began shipping in January 2005 and as a result of lower than anticipated sales and to further our strategy and focus on our Joe s® brand, in January 2006, we announced that we were exiting the operation of the indie brand. Over the course of fiscal 2006, we sold the remaining inventory. However, we continue to own the trademark applications that have been issued internationally.

Betsey Johnson® License Agreement

On July 22, 2005, we entered into a termination settlement agreement and mutual release with B.J. Vines, licensor of the Betsey Johnson® apparel brand, to provide for the immediate termination of the license agreement under which IAA had the exclusive right to design, market, and distribute women s denim and coordinating denim related apparel under the Betsey Johnson® brand name in the United States and Canada. Because of lower than anticipated sales, the parties believed that the termination of the agreement was in the best interest of the parties.

In exchange for the early termination of the license agreement and a general release by both parties, IAA paid to B.J. Vines a one-time payment in the amount of $350,000. This one time payment represented a significant amount less than the minimum guaranteed royalties that IAA would have otherwise been required to pay during the remaining three years of the license. In connection with the termination, IAA has no further obligations under the license agreement, and all ancillary documents, which included a personal guarantee by the original licensee, were also terminated. During fiscal 2006, we sold the limited amount of remaining inventory and beginning in the fourth quarter of fiscal 2006, we did not have any additional sales related to this terminated apparel line.

Fetish , Shago® and Hot Wheels®

During fiscal 2004, we terminated three other branded apparel licenses as a result of our decision to exit the urban apparel market and shift our focus and resources on denim and denim-related apparel. However, throughout the course of fiscal 2005, we continued to have some limited sales of excess inventory pursuant to our settlement agreements. As a result, these limited net sales of Fetish and Shago® branded apparel are included in net sales of other branded apparel for fiscal 2005. There were never any sales of the Hot Wheels® branded apparel line. We have no further obligations under our settlement agreements other than customary continuing rights related to indemnification, audits and maintenance of books and records.

Sales, Distribution and Outsourcing Agreements

Joe s®

Domestically, our Joe s® branded apparel products are sold to retailers and specialty stores through independent third party showrooms located in Los Angeles and New York where retailers review the latest collections offered by Joe s and place orders. The showroom representatives provide us with purchase orders from the retailers and other specialty store buyers. Pursuant to our arrangement with each of these showrooms, we pay sales commissions at an agreed upon percentage of sales less discounts, returns and other credit allowances. In addition, pursuant to our license agreement, we pay to JD Design a royalty of 3% on net sales. If the merger agreement is approved, we will no longer pay the royalty, but we will be obligated to pay certain additional salary amounts to Joe Dahan based upon gross profit and net sales. Under our outsourcing arrangement, Pixior warehouses, picks, packs and ships our Joe s products directly to the retailer or specialty store from its warehouse.

Internationally, we have sold our Joe s® branded apparel products through a Master Distribution Agreement, or MDA, with Beyond Blue Inc., or BBI, a Los Angeles-based company that specializes in international consulting, distribution and licensing for apparel products. Pursuant to the MDA entered into on January 1, 2004, Joe s granted to BBI the exclusive distribution rights for Joe s products outside the United States. Under the MDA s terms, BBI established sub-distributors and sales agents in certain international markets through sub-distribution arrangements and assumed our obligations under a prior agreement with Itochu Corporation, or Itochu, for the Japanese market. The initial term of the MDA was through June 30, 2007, with an option to renew under an amendment. Under the terms of the MDA, we sold our Joe s products to BBI at 22.5% discount from our wholesale price, which they then re-sold to various international retailers and sub-distributors. On February 1, 2007, we and BBI mutually agreed to dissolve the MDA. Under the terms of the dissolution, we have been assigned the rights associated with the sub-distributors in various countries and are continuing to work with existing international distributors in each country.

For the Japanese market, on July 1, 2003, Joe s entered into a three year Distribution and Licensing Agreement with Itochu pursuant to which Itochu obtained certain manufacturing and licensing rights for the Joe s® marks in Japan. As part of the MDA with BBI, we assigned our rights under the agreement with Itochu to BBI. The agreement with Itochu automatically ended on December 31, 2006, and we are currently working with them on a purchase order basis.

As a result of the dissolution of these two agreements, we are internally evaluating our options with respect to our international business and are reviewing our relationships in the international marketplace to create a strategy to improve and grow our international sales.

In April 2006, we announced that we entered into an agreement with Pixior to outsource our product fulfillment services, including our warehousing, distribution and customer services needs for our branded apparel products. We began operating under this agreement in the third quarter of fiscal 2006. In addition, in mid-July 2006, we moved our principal executive offices to space located within Pixior s current space under a verbal month to month arrangement for the use of general administrative offices. We pay Pixior $10,000 a month as a facility rent expense in addition to the fee we pay for our product fulfillment services.

Other Branded Apparel

For our other branded apparel lines, such as indie and Betsey Johnson®, we utilized a combination of internal sales, independent sales representative or third party showroom arrangements to meet with retailers to review the latest collections offered under the respective brand and place orders. In February 2005, we entered into a Master Distribution Agreement similar to our Joe s MDA with BBI for the international distribution of our indie products, which we mutually agreed to no longer operate under after our decision to exit the indie branded apparel line.

Advertising, Marketing and Promotion

Historically, our advertising campaign for our Joe s® brand has been limited to strategic placement of advertising in areas of high concentration of fashion advertising. We marketed through billboard advertisement in Los Angeles, California, and leased advertising space on the tops of taxi cabs in New York City. These advertising spaces have been outfitted with Joe s unique and eye-catching ads which primarily feature women s silhouettes. In addition, we have an internal public relations person to strategically place our products in magazines, editorials, and with stylists.

Sales through existing retail channels are enhanced by visual merchandising. For example, many of our customer s stores have denim focus areas located within a department that are dedicated to selling and showcasing our Joe s® merchandise on a year round basis.

Customers

Joe s®

Our Joe s products are sold to consumers through high-end department stores and boutiques located throughout the world.

We currently sell our Joe s® apparel to domestic retailers such as Barneys New York, Federated Department Stores Inc., which includes Bloomingdale s, Macy s, and Marshall Field s, Henri Bendel, Neiman Marcus, Nordstrom, and Saks Fifth Avenue, and specialty retailers such as American Rag, Anthropology, Atrium, Bergdorf Goodman Lisa Klein, Ron Herman, Fred Segal, and Scoop NYC in the United States. We sell internationally to retailers such as Galleries Lafayette, Le Bon Marche, and Le Printemps in France, Barney s Japan, Isetan, and Mitsukoshi in Japan, Harvey Nichols and Selfridges & Co. in the United Kingdom, Ztampz in Hong Kong and Gio Moretti in Italy.

The Joe s® website, www.joesjeans.com, has been established to promote and advance the brand s image and to allow consumers to review and purchase online the latest collection of products. The information available on Joe s® website is not intended to be incorporated into this Annual Report. Joe s currently uses both online and print advertising to create brand awareness with customers as well as consumers.

For fiscal 2006, Joe s three largest customers and customer groups accounted for approximately 42% of its net sales. While, this is a high percentage of sales, attributable to three customer groups, we believe that we would be able to find alternative customers to purchase Joe s products in the event of the loss of any of these existing customers. For example, Joe s largest customer was Federated Department Stores Inc. which includes Bloomingdale s, Macy s, and Marshall Field s.

Other Branded Apparel

During fiscal 2006, we sold the remaining indie and Betsey Johnson® inventory primarily to discount liquidators.

We do not enter into long-term agreements with any of our customers. Instead, we receive individual purchase order commitments from our customers. A decision by the controlling owner of a group of stores or any other significant customer, whether motivated by competitive conditions, financial difficulties or otherwise, to decrease the amount of merchandise purchased from us, or to change their manner of doing business with us, could have a material adverse effect on our financial condition and results of operations. See Risk Factors A portion of our net sales and gross profit is derived from a small number of large customers.

Seasonality of Business and Working Capital

Products are designed and marketed primarily for four principal selling seasons, Spring, Summer, Fall/Back-to-School and Winter/Holiday. Typically, we have approximately a twelve to fourteen week turnaround time between the time we book an order and when we ship it. Our primary booking periods for the retail sales seasons are as follows:

Retail Sales Season	**Primary Booking Period**
Spring	September-November
Summer	November-March
Fall/Back-to-School	February-May
Winter/Holiday	June-August

We have historically experienced and expect to continue to experience seasonal fluctuations in our net sales. Historically, a significant amount of our net sales are realized during the third and fourth quarter when we ship orders taken during earlier months. In the second quarter in order to prepare for peak sales that occur during the second half of the year, we build inventory levels, which results in higher liquidity needs compared to other quarters. If sales are materially different from seasonal norms during the third quarter, our annual operating results could be materially affected. Accordingly, our results for the individual quarters are not necessarily indicative of the results to be expected for the entire year.

During fiscal 2006, we utilized financing agreements with CIT Commercial Services, a unit of CIT Group, Inc., or CIT, to provide us with our working capital needs through the sale of our account receivables and advances against certain eligible inventory. See Management s Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources for further discussion of our financing agreements with CIT.

Based upon our historical growth, we may need to obtain additional working capital in order to meet our operational needs in fiscal 2007. While we expect to fund our operational needs by relying on the availability of funds offered to us under our financing agreements with CIT, we believe that any additional capital, to the extent needed, may be obtained through alternative short-term financing arrangements. We also have funds available to us as a result of proceeds from the sale of equity and warrants during our first quarter of fiscal 2007 in December 2006. See Managements Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources for a further discussion of our capital needs. However, there can be no assurance that this or other financing will be available if needed. Our inability to fulfill any interim working capital requirements would force us to contract our operations.

Credit and Collection

We currently extend credit to a majority of our larger customers, who purchase our products from us at wholesale. Our decision to extend credit is based on factors such as credit approval by CIT under our factoring arrangements, past credit history, reputation of creditworthiness within our industry, and timelines of payments made to us. We generally extend this credit without requiring collateral. A percentage of our customers are required to pay by either cash before delivery, credit card or cash on delivery, or C.O.D., which is also based on such factors as lack of credit history, reputation (or lack thereof) within our industry and/or prior payment history. For those customers to whom we extend credit, typical terms are net 30 to 60 days. Based on industry practices, financial awareness of the customers with whom we conduct business, and business experience of our industry, our management exercises professional judgment in determining which customers will be extended credit. We are exposed to some collection risk for receivables which were factored with recourse where CIT did not accept the credit risk. However, the aggregate amount of exposure is generally low and, therefore, we believe that the credit risk associated with our extension of credit is minimal.

Backlog

Although we may, at any given time, have significant business booked in advance of ship dates, customers purchase orders are typically filled and shipped within two to six weeks. As of November 25, 2006, we had backlog of $16,600,000 for Joe s®. The amount of outstanding customer purchase orders at a particular time is influenced by numerous factors, including the product mix, timing of the receipt and processing of customer purchase orders, shipping schedules for the product and specific customer shipping windows. Due to these factors, a comparison of outstanding customer purchase orders from period to period is not necessarily meaningful and may not be indicative of eventual actual shipments.

Competition

The apparel industry in which we operate is fragmented and highly competitive in the United States and on a worldwide basis. We compete with a large number of apparel companies similar to ours for consumers. Our primary branded competitors include Seven for All Mankind, Citizens of Humanity, and Rock & Republic. We do not hold a dominant competitive position, and our ability to sell our products is dependent upon the anticipated popularity of our designs and brand name, the price and quality of our products and our ability to meet our customers delivery schedules.

We believe that we are competitive with companies producing goods of like quality and pricing, and that new product development, product identity through marketing, promotions and competitive price points will allow us to maintain our competitive position. However, many of our competitors may possess greater financial, technical and other resources than us. Furthermore, the intense competition and the rapid changes in consumer preferences constitute significant risk factors in our operations. As we expand globally, we will continue to encounter additional sources of competition. See Risk Factors We face intense competition in the worldwide apparel industry.

Imports Restrictions and Other Governmental Regulations

Transactions with our foreign manufacturers and suppliers are subject to the general risks of doing business abroad. Imports into the United States are affected by, among other things, the cost of transportation and the imposition of import duties and restrictions. The countries in which our products might be manufactured may, from time to time, impose new quotas, duties, tariffs or other restrictions, or adjust presently prevailing quotas, duty or tariff levels, which could affect our operations and our ability to import products at current or increased levels. We cannot predict the likelihood or frequency of any such events occurring. The enactment of any additional duties, quotas or restrictions could result in increases in the cost of our products generally and might adversely affect our sales and profitability.

Our import operations are subject to international trade agreements and regulations such as the North American Free Trade Agreement and other bilateral textile agreements between the United States and a number of foreign countries, including Hong Kong, China, Taiwan and Korea. Some of these agreements impose quotas on the amount and type of goods that can be imported into the United States from these countries. Such agreements also allow the United States to impose, at any time, restraints on the importation of categories of merchandise that, under the terms of the agreements, are not subject to specified limits. Some of our imported products are also subject to United States customs duties and, in the ordinary course of business, we are from time to time subject to claims by the United States Customs Service for duties and other charges.

Because our foreign manufacturers are located at greater geographic distances from us than our domestic manufacturers, we are generally required to allow greater lead time for foreign orders, which reduces our manufacturing flexibility. Foreign imports are also affected by the high cost of transportation into the United States.

In addition to the factors outlined above, our future import operations may be adversely affected by political instability resulting in the disruption of trade from exporting countries, any significant fluctuation in the value of the dollar against foreign currencies and restrictions on the transfer of funds.

Discontinued Operations

Beginning in fiscal 2004, we classified certain of our 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, our commercial rental property consisting of four separate buildings that served as our former headquarters located in Springfield, Tennessee and the remaining assets of our craft and accessory business segment conducted through our Innovo Inc. subsidiary were both first classified as discontinued operations. On May 17, 2005, we completed the sale of the assets of our craft and accessory segment of operations. In February 2006, we completed an auction of each of the four separate buildings that served as our former headquarters.

In January 2006, in connection with our Board of Directors decision to focus our operations on our Joe s® brand, we began to look for a purchaser for our private label apparel division operated by our IAA subsidiary that we originally purchase in July 2003 from Azteca Production International, Inc., or Azteca. Because the sale of these assets was subject to obtaining approval of our stockholders, the potential sale of the private label division assets did not meet the criteria of an asset held for sale and thus could not be considered a discontinued operation until the sale was completed. On May 12, 2006, we completed the sale of our private label apparel division and accordingly, reported it as a discontinued operation on our Quarterly Report on Form 10-Q for the period ended May 27, 2006. As such, all prior periods have been reclassified to reflect this operating division as a discontinued operation.

Human Resources

As of February 7, 2006, we had 81 full-time employees and we consider our relationships with our employees to be good.

Financial Information about Geographical Areas

See Notes to Consolidated Financial Statements - Note 14 Segment Reporting and Operations by Geographical Area for further discussion of financial information about geographical areas.

Available Information

Our website address is www.innovogroup.com. We make available on or through our website, without charge, our Annual Report, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15 (d) of the Securities Exchange Act of 1934, as amended, as soon as reasonably practicable after such reports are electronically filed with or furnished to the SEC. Although we maintain a website at www.innovogroup.com, we do not intend that the information available through our website be incorporated into this Annual Report. In addition, any materials filed with, or furnished to, the SEC may be read and copied at the SEC s Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549 or viewed on line at www.sec.gov. Information regarding the operation of the Public Reference Room can be obtained by calling the SEC at (202) 551-8090.

Executive Officer

The following table sets forth certain information regarding our executive officer:

Name	Age	Position
Marc B. Crossman	35	Chief Executive Officer, (Principal Executive Officer), President, Chief Financial Officer (Principal Financial Officer) and Director

Marc B. Crossman has served as our Chief Financial Officer since March 2003 and a member of our Board of Directors since January 1999. In September 2004, Mr. Crossman was appointed to the position of President and in January 2006, Mr. Crossman was appointed to the position of Interim Chief Executive Officer. In May 2006, the Interim title was removed.

ITEM 1A. RISK FACTORS

The following risk factors should be read carefully in connection with evaluating our business and the forward-looking statements contained in this Annual Report. Any of the following risks could materially adversely affect our business, our operating results, our financial condition and the actual outcome of matters as to which forward-looking statements are made in this Annual Report.

We may not be successful in implementing our strategic plan to focus our resources on our Joe s® brand.

Our ongoing business operations focus our resources on our Joe s® brand. While to date, this has been our best performing asset, we cannot assure you that our reliance on sales from only one brand in the marketplace will result in profitability for us. We cannot assure you that our Joe s® brand will continue to meet our expectations in terms of sales, profits and acceptance in the marketplace by consumers and retailers. Therefore, our business operations could be negatively impacted by a change in any one or all of these expectations and may have a material adverse impact on our financial condition and results of operations.

Our operations could be dependent on our ability to execute on our exploration of strategic initiatives for our business, including our proposed merger agreement with JD Holdings.

In January 2006, we announced that our Board of Directors decided to explore strategic initiatives related to our business, including the possible sale of some or all of our assets. In furtherance of these initiatives, in February 2007, we announced that we entered into a merger agreement with JD Holdings to purchase all right, title and interest in the Joe s® brand and marks. We believe that the purchase of the Joe s® brand and marks will give us the right to control the direction of the brand. However, this merger is subject to the approval of our stockholders and we cannot assure you that the transaction will be approved or that this change will result in profitability for us. While we believe that this transaction may ultimately enhance stockholder value, we cannot assure you that this or any transaction will result in enhanced economic value or profitability. In addition, in the event that the merger is approved, we expect to seek opportunities to license the Joe s® brand and marks under license agreements for categories of products that we do not produce. We cannot assure you that this strategy will work or result in increased revenue for us.

Due to our negative cash flows, we could be required to cut back or stop operations if we are unable to raise or obtain needed funding.

Our ability to fund our operations will depend on (i) utilizing our receivable and inventory based agreements with CIT; (ii) utilizing the proceeds from our equity financing in December 2006; (iii) maximizing our trade payables with our domestic and international suppliers; (iv) managing our inventory levels and operating expenses; and (v) increasing collection efforts on existing account receivables.

Our primary method to obtain the cash necessary for operating needs is through the sale of our account receivables under our factoring agreements and ability to obtain advances under our inventory security agreements, or the Factoring Facilities, with CIT. These Factoring Facilities give us, through our operating subsidiaries, the ability to obtain cash by selling to CIT certain of our account receivables 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 us to obtain advances for up to 50% of the value of certain eligible inventory. We currently obtain 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 us pursuant to the Factoring Facilities. As further assurance to enter into the Factoring Facilities, cross guarantees were executed by and among us, Innovo, Joe s and IAA, to guarantee each subsidiaries obligations and in November 2004, upon request by CIT, our Chairman, Sam Furrow, executed a personal guarantee for up to $1,000,000. This personal guarantee by Mr. Furrow has contributed to our ability to obtain cash under our existing Factoring Facilities. In addition, in October 2006, JD Design granted to CIT a security interest in the Joe s® trademarks and executed a non-recourse guaranty in favor of CIT to allow us to obtain additional advances under our inventory security agreement. In connection with the security interest and guaranty, we entered into an agreement with JD Design to provide protection to JD Design through the potential issuance of shares of our common stock as collateral for the non-recourse guaranty and security interest granted to CIT. See Notes to Consolidated Financial Statements - Note 6 Account Receivables, Inventory Advances and Due (to) Factor and Note 13 Commitments and Contingencies for further discussion of our Factoring Facilities with CIT and the Collateral Protection Agreement with JD Design.

As of November 25, 2006, our availability with CIT was approximately $425,000 under the Factoring Facilities. This amount fluctuates on a daily basis based upon invoicing and collection related activity by CIT on our behalf. In connection with the agreements with CIT, certain assets are pledged to CIT, including all of our inventory, merchandise, and/or goods, including raw materials through finished goods and receivables.

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

Because our negative cash flows could cause CIT to terminate the Factoring Facilities after notice, we may be forced to pay our liability with CIT, which could include CIT exercising its right to take possession of the pledged collateral, which includes raw materials through finished goods and receivables. Although we have undertaken numerous measures to increase sales, control inventory costs and operate more efficiently so that we may be able to continue to fund our operations for fiscal 2007, we may continue to experience losses and negative cash flows. We can give you no assurance that we will in fact operate profitably in the future.

We rely on our Joe s ® License Agreement to generate our revenues.

Our sales are dependent upon our Joe s® license. Although we believe we will continue to meet all of our material obligations under this license agreement, there can be no assurance that such license rights will continue or will be available for renewal beyond the rights that we have under the agreement. We are dependent on our revenue from this license agreement to fund our continuing operations. Because of this reliance, we have entered into the merger agreement with JD Holdings so that we can, if we obtain stockholder approval, own all right, title and interest to the Joe s® brand and marks. By owning the brand and the marks, we eliminate the possibility of losing the license that we rely on to generate revenue.

We outsource certain of our business operations and are dependent, to a degree, on third parties to perform these services for us.

In connection with our operations, we outsource certain services and are dependent on third parties such as Azteca for the manufacture and Pixior for product fulfillment of our apparel products. The inability of one or more of these service providers to manufacture, ship or fulfill our customer purchase orders in a timely manner or to meet our quality standards could cause us to miss the delivery dates for our customers for those items. As a result, our customers may decide to cancel orders, refuse to accept delivery of the products or cause us to provide discounts or allowances. Any of these events could have a material adverse effect on our financial condition and results of operation.

We are dependent on our relationships with our vendors.

We purchase our raw materials, including fabric, yarns, threads and trims, such as zippers, buttons, tags from a variety of vendors. While we are not reliant exclusively on one or more particular vendor for the supply of the raw materials or component parts required to meet our manufacturing needs, we depend on our relationships and these vendors to ensure our supply of these raw materials or component parts. Any problems or disputes with these vendors could result in us having to source these raw materials or component parts from another vendor, which could delay production, and in turn have a material adverse effect on our financial condition and results of operation.

Our common stock price is extremely volatile and may decrease rapidly.

The trading price and volume of our common stock has historically been subject to wide fluctuation in response to factors such as the following, some of which are beyond our control:

- annual and quarterly variations in actual or anticipated operating results,
- operating results that vary from the expectations of securities analyst and investors,
- changes in expectations as to our future financial performance, including financial estimates by securities analysts and investors,
- changes in market valuations of other denim apparel companies,
- announcements of new product lines by us or our competitors, announcements by us or our competitors of significant contracts, acquisitions or dispositions of assets, strategic partnerships, joint ventures or capital commitments,
- additions or departures of key personnel or members of our board of directors, and
- general conditions in the apparel industry.

In the 52 week period prior to February 7, 2007, the closing price of our common stock has ranged from $0.37 to $1.45. In addition, stock markets generally have experienced extreme price and volume trading volatility in recent years. This volatility has had a substantial effect on the market prices of securities of many companies for reasons frequently unrelated to the operating performance of the specific companies. These broad market fluctuations may significantly and negatively affect the market price of our common stock.

If we cannot meet the Nasdaq Capital Market maintenance requirements and Nasdaq rules, Nasdaq may delist our common stock, which could negatively affect the price of the common stock and your ability to sell the common stock.

In the future, we may not be able to meet the listing maintenance requirements of the Nasdaq Capital Market, formerly known as the Small Cap Market, and Nasdaq rules, which require, among other things, minimum stockholders equity of $2.5 million, a minimum bid price for our common stock of $1.00, and a requirement that a majority of our Board of Directors be independent, as defined in the Nasdaq rules.

On June 30, 2006, we announced that we received a Nasdaq staff deficiency notice indicating that we were no longer in compliance with Nasdaq Rule 4310(c)(4) because the closing bid price per share of our common stock was below $1.00 per share for 30 consecutive trading days. We were provided with 180 calendar days, or until December 27, 2006, to regain compliance with this rule. On December 29, 2006, we announced that we had received a second letter from Nasdaq on December 28, 2006. The second letter notified us that since we did not regain compliance by December 27, 2006, but otherwise met the initial listing criteria set forth in Nasdaq Rule 4310(c) except for the bid price requirement, we were eligible for an additional 180 calendar days, or until June 25, 2007, to regain compliance. On January 29, 2007, we announced that we had regained compliance with the minimum bid price rule. However, there can be no assurance that we will be able to maintain the bid price of our common stock at $1.00 and not violate this rule or other Nasdaq requirements in the future.

If we are unable to satisfy Nasdaq criteria for maintaining listing, our common stock would be subject to delisting. Trading, if any, of our common stock would thereafter be conducted in the over-the-counter market, in the so-called pink sheets or on the National Association of Securities Dealers, Inc., or NASD, electronic bulletin board. As a consequence of any such delisting, a stockholder would likely find it more difficult to dispose of, or to obtain accurate quotations as to the prices of our common stock.

Our directors and management beneficially own a large percentage of our common stock.

Our executive officer and directors beneficially own approximately 18% of our common stock, including options exercisable within 60 days of February 7, 2006, in the aggregate. More specifically, the Chairman of our Board, Sam Furrow, beneficially owns approximately 8.1% of our common stock, and Jay Furrow, our former Chief Executive Officer, current member of our Board and the son of Sam Furrow, beneficially owns approximately 4.6% of our common stock. Because of this level of stock ownership, in the aggregate, certain persons may be in a position to directly or indirectly control our affairs. Our bylaws also limit the ability of stockholders to call a special meeting of stockholders. These bylaw provisions could have the effect of discouraging a takeover of us, and therefore may adversely affect the market price and liquidity of our securities. We are also subject to a Delaware statute regulating business combinations that may hinder or delay a change in control. The anti-takeover provisions of the Delaware statute may adversely affect the market price and liquidity of our securities.

We are dependent, to a degree, on manufacturing arrangements with Azteca certain stockholders and their related entities to produce a substantial portion of our products. In addition, we have historically in the past granted them certain rights which may result in the ability to influence us to a degree.

Over the course of our relationship with Azteca, Commerce, Hubert Guez and Paul Guez, we have at certain times entered into a variety of agreements with them, including purchase agreements and manufacturing and distribution arrangements, verbal and written. Azteca and Commerce are entities controlled by Hubert Guez and/or Paul Guez. Our business is dependent in part with our ability to work with Azteca, Commerce and each of the Guez brothers.

Our relationship with the Guez brothers and their entities began in the summer of 2000 when we entered into a securities purchase agreement with them. Thereafter, we utilized this relationship in order to enter into the denim apparel and design business. To foster business growth, we entered into certain supply and distribution agreements with them and also moved our headquarters from Tennessee to Los Angeles to office and warehouse space under a verbal shared facility arrangement. Over the course of the next few years, the Guez brothers maintained an interest in us through stock ownership and through the various manufacturing, supply and distribution arrangements.

In fiscal 2006, as a result of the prior relationship, we entered into a manufacturing arrangement with them to manufacture some of our Joe s® denim bottoms in Mexico through their Mexican subsidiary, AZT. In fiscal 2006, we purchased approximately $12,845,000 in goods and services, or 55% of our total purchases from AZT and its affiliates. Therefore, the loss of our manufacturing arrangements with AZT could adversely affect our current supply responsibilities. If we, due to unforeseen circumstances are unable to utilize the services of AZT for manufacturing, our operations may be adversely affected until we are able to secure manufacturing arrangements with other suppliers that could provide a similar magnitude of services to us. In addition, developing and finding such alternative suppliers for such services may take focus, time and effort from management s attention to other operations.

Over the course of the relationship and as we have grown and changed our business plans, the Guez brothers and their related entities have decreased their stock ownership and decreased the amount and types of operational arrangements with us. Presently, we only utilize AZT to manufacture our products. We no longer share office space with them and based upon a Schedule 13D/A filed by Paul Guez, Azteca, and Hubert Guez on July 17, 2006, and a Form 4 filed on January 26, 2007, the Guez brothers, including entities owned or controlled by them, beneficially own approximately 16% of our common stock in the aggregate. In addition, we granted certain rights in 2000 in connection with investments made by Commerce and other investors affiliated with Hubert Guez and Paul Guez, including a Mr. Joseph Mizrachi, whereby they may have the right to designate three individuals and one individual, respectively, for election to our board of directors. If any or all of the designated directors are elected, then our board has the obligation to appoint at least one designated director to each of its committees. As of February 21, 2003, the Mizrachis ceased to be the beneficial owners of more than 5% of our securities. Because of this level of stock ownership, in the aggregate, and the right to appoint members to our board, they may be in a position to directly or indirectly influence our affairs.

The seasonal nature of our business makes management more difficult, severely reduces cash flow and liquidity during parts of the year and could force us to curtail our operations.

Our business is seasonal. The majority of our marketing and sales activities take place from late fall to early spring. Historically, our greatest volume of shipments and sales have occurred from late spring through the summer, which coincides with our second and third fiscal quarters. This requires us to build-up inventories during our first and second fiscal quarters when our cash flow is weakest. Historically speaking, our cash flow is strongest in the third and fourth fiscal quarters. Unfavorable economic conditions affecting retailers during the fall and holiday seasons in any year could have a material adverse effect on our results of operations for the year. We are likely to experience periods of negative cash flow throughout each year, including, a drop-off in business commencing each December, which could force us to curtail operations if adequate liquidity is not available. We cannot assure you that the effects of such seasonality will diminish in the future.

We face risks associated with constantly changing fashion trends, including consumer s response to our Joe s® branded apparel.

Our success will depend on our ability to anticipate, gauge and respond to changing consumer demand and fashion trends in a timely manner, in particular, consumer demand for our Joe s® branded apparel. Any failure on our part to anticipate, identify and respond effectively to changing consumer demands and fashion trends could adversely affect the acceptance of our products and leave us with a substantial amount of unsold inventory or missed opportunities in the marketplace. If that occurs, we may be forced to rely on markdowns or promotional sales to dispose of excess, slow-moving inventory, which may negatively affect our ability to achieve profitability. At the same time, a focus on tight management of inventory may result, from time to time, in our not having an adequate supply of products to meet consumer demand and may cause us to lose sales.

In addition, we face risks associated with delivering an entire collection of items, including, fashion t-shirts, tops, sweaters and bottoms in fabric other than denim, of fashion-forward apparel items bearing the Joe s® brand name. We attempt to minimize our risk associated with these products through early order commitments by retailers. We must generally place production orders with manufacturers before we have received all of a season s orders and orders may be cancelled by retailers before shipment. Therefore, if we fail to anticipate accurately and respond to consumer preferences, we could experience lower sales, excess inventories or lower profit margins, any of which could have a material adverse effect on our results of operations and financial condition.

Our business could be negatively impacted by a change in consumer demand for denim in the marketplace.

Denim, including premium denim, an industry term for denim jeans with a typical retail price of $120 or more, has been increasingly popular and growing in sales over the past few years as a consumer discretionary purchase both domestically and internationally. However, because consumer demands and fashion trends are subject to cyclical variations as well as the fact that the general economy and future economic prospects can often affect consumer spending habits, a change in any one of the following:

- consumer demand,
- consumer purchases of discretionary items,
- the economy in general, or
- fashion trends,

any of which may result in lower sales, excess inventories or lower profit margins for our Joe s® products, any of which could have a material adverse effect on our results operations and financial condition.

Our Joe s® business may not experience the growth we expect if we are unable to execute on our plan to increase our international sales.

Continued growth of our Joe s® brand may be dependent, in part, on our ability to increase our international net sales. During fiscal 2006, our international net sales decreased compared to fiscal 2005 partially as a result of delays in producing samples for use at international trade shows. On February 1, 2007, we and our international distributor mutually agreed to dissolve our agreement for international distribution. Under the terms of the dissolution, we have been assigned the rights associated with the sub-distributors in various countries and are continuing to ship to our international distributors. Further, our distribution agreement for the Japanese market automatically ended on December 31, 2006, and we are currently working with them on a purchase order basis. As a result of the dissolution of these two agreements, we are internally evaluating our options with respect to our international business and are reviewing our relationships in the international marketplace to create a strategy to improve and grow our international sales. While we believe that our strategy for fiscal 2007 will improve our international sales, there can be no assurance that we will be able to achieve our expectation level of net sales in the international marketplace. Further, there can be no assurance that our styles, fits and washes will gain acceptance in the international marketplace, as we primarily design with the domestic customer in mind.

Lack of growth in the international market could have a material adverse effect on our results operations and financial condition.

A portion of our net sales and gross profit is derived from a small number of large customers.

Our 10 largest customers and customer groups accounted for approximately 60% of our net sales during fiscal 2006. We do not enter into any type of long-term agreements or firm commitment orders with any of our customers. Instead, we enter into a number of individual purchase order commitments with our customers. A decision by the controlling owner of a group of stores or store or any other significant customer, including our limited number of private label customers, whether motivated by competitive conditions, financial difficulties or otherwise, to decrease the amount of merchandise purchased from us, or to change their manner of doing business with us, could have a material adverse effect on our financial condition and results of operations if we were unable to find an alternative customer for our products in a timely manner.

Our business could be negatively impacted by the financial health of our retail customers.

We sell our product primarily to retail and distribution companies around the world based on pre-qualified payment terms. Financial difficulties of a customer could cause us to curtail business with that customer, in addition to the customer s decision to decrease the level of its orders, to cancel orders previously placed in advance of shipment dates or to cease carrying our products. We may also assume more credit risk relating to that customer s receivables. We are dependent primarily on lines of credit that we establish from time to time with customers, and should a substantial number of customers become unable to pay to us their respective debts as they become due, we may be unable to collect some or all of the monies owed by those customers.

In recent years, the retail industry has experienced consolidation or other ownership changes that have resulted in one entity controlling several different stores. This consolidation can result in fewer customers for our products or the closing of some stores or the number of doors which carry our products. As a result, the potential for consolidation or ownership changes, closing of retail outlets and fewer customers could negatively impact sales of our products and have a material adverse effect on our financial condition and results of operations.

The loss of the services of key personnel could have a material adverse effect on our business.

Our executive officer has substantial experience and expertise in our business and has made significant contributions to our growth and success. The unexpected loss of services of this individual could adversely affect us. We are currently not protected by a key-man or similar life insurance covering our executive officer, nor do we have a written employment agreement with our executive officer who serves as our Chief Executive Officer, President and Chief Financial Officer. If, for example, our executive officer should leave us, his services would likely have a substantial impact on our ability to operate, on a daily basis, because we would be forced to find and hire similarly experienced personnel to fill one or more of those positions, and daily operations may suffer temporarily as a result of this immediate void.

Furthermore, with respect to Joe s, while we maintain an employment agreement with Joe Dahan and expect to enter into a new agreement if the merger transaction is completed, Mr. Dahan s departure from Joe s could materially adversely affect our operations because his experience, design capabilities, and name recognition in the apparel industry is important to our business and we rely heavily on Mr. Dahan s capabilities to design, direct and produce product for the Joe s brand. However, the loss of Mr. Dahan would not terminate our existing agreement pursuant to which we license the use of Joe s® and the JD logo, nor would it have any effect on the brand should the merger be approved. While we believe that we would be able to find a suitable replacement to design, direct and produce product for the Joe s brand, we do not know the effect a new or different designer would have on the products and consumer s response to those new products. Therefore, loss of such service could have an impact on our ability to operate on a daily basis and daily operations may suffer temporarily as well.

Our business could suffer as a result of manufacturer s inability to produce our goods on time and to our specifications or if we need to replace manufacturers.

We do not own or operate any manufacturing facilities and therefore depend upon independent third parties for the manufacture of all of our products. Our products are manufactured to our specifications by both domestic and international manufacturers. In part, we are partially dependent on AZT and its affiliates as a manufacturer to the extent that they manufactured approximately 55% of our products during fiscal 2006. During fiscal 2006, approximately 41% of our products were manufactured in the United States and approximately 59% of our products were manufactured in Mexico or foreign countries. The inability of a certain manufacturer to ship orders of our products in a timely manner or to meet our quality standards could cause us to miss the delivery date requirements of our customers for those items, which could result in cancellation of orders, refusal to accept deliveries or a reduction in purchase prices, any of which could have a material adverse effect on our financial condition and results of operations. Because of the seasonality of our business, and the apparel and fashion business in particular, the dates on which customers need and require shipments of products from us are critical, as styles and consumer tastes change so rapidly in the apparel and fashion business, particularly from one season to the next. Further, because quality is a leading factor when customers and retailers accept or reject goods, any decline in quality by our third-party manufacturers could be detrimental not only to a particular order, but also to our future relationship with that particular customer.

We compete with other companies for the production capacity of our manufacturers. Some of these competitors have greater financial and other resources than we have, and thus may have an advantage in the competition for production and import quota capacity. If we experience a significant increase in demand, or if an existing manufacturer of ours must be replaced, we may have to expand our third-party manufacturing capacity. We cannot assure you that this additional capacity will be available when required on terms that are acceptable to us or similar to existing terms which we have with our manufacturers, either from a production standpoint or a financial standpoint. We enter into a number of purchase order commitments each season specifying a time for delivery, method of payment, design and quality specifications and other standard industry provisions, but do not have long-term contracts with any manufacturer. None of the manufacturers we use produces our products exclusively.

Should we be forced to replace one or more of our manufacturers, particularly a manufacturer that we may rely upon for a substantial portion of our production needs, such as AZT, then we may experience an adverse financial impact, or an adverse operational impact, such as being forced to pay increased costs for such replacement manufacturing or delays upon distribution and delivery of our products to our customers, which could cause us to lose customers or lose revenues because of late shipments.

If an independent manufacturer of ours fails to use acceptable labor practices, our business could suffer.

While we require our independent manufacturers to operate in compliance with applicable laws and regulations, we have no control over the ultimate actions of our independent manufacturers. Despite our lack of control, we have internal and vendor operating guidelines to promote ethical business practices and our staff periodically visits and monitors the operations of our independent manufacturers. We also utilize the services of a third party independent labor consulting service to conduct on site audits as required by state labor laws to help minimize our risk and exposure to unacceptable labor practice violations. The violation of labor or other laws by one of our independent manufacturers or the divergence of an independent manufacturer s labor practices from those generally accepted as ethical in the United States, could interrupt or otherwise disrupt the shipment of finished products to us or damage our reputation. Any of these, in turn, could have a material adverse effect on our financial condition and results of operations. In particular, the laws governing garment manufacturers in the State of California impose joint liability upon us and our independent manufacturers for the labor practices of those independent manufacturers. As a result, should one of our independent manufacturers be found in violation of state labor laws, we could suffer financial or other unforeseen consequences.

Our trademark and other intellectual property rights may not be adequately protected outside the United States and some of our products are targets of counterfeiting.

We believe that our trademarks and other proprietary rights are important to our success and our competitive position. We may, however, experience conflict with various third parties who acquire or claim ownership rights in certain trademarks as we expand our product offerings and expand the number of countries where we sell our products. We cannot ensure that the actions we have taken to establish and protect these trademarks and other proprietary rights will be adequate to prevent imitation of our products by others or to prevent others from seeking to block sales of our products as a violation of their trademarks and proprietary rights. Also, we cannot assure you that others will not assert rights in, or ownership of, trademarks and other proprietary rights of ours or that we will be able to successfully resolve these types of conflicts to our satisfaction. In addition, the laws of certain foreign countries may not protect proprietary rights to the same extent as do the laws of the United States.

Our Joe s® products are sometimes the target of counterfeiters. As a result, there are often products that are imitations or knock-offs of our Joe s® products that can be found in the marketplace or consumers can find products that are confusingly similar to ours. We intend to vigorously defend our trademarks and products bearing our trademarks, however, we cannot assure you that our efforts will be adequate to prosecute and block all sales of infringing products from the marketplace.

Our ability to conduct business in international markets may be affected by legal, regulatory, political and economic risks.

Our ability to capitalize on growth in new international markets and to maintain the current level of operations in our existing international markets is subject to risks associated with international operations. Some of these risks include:

- the burdens of complying with a variety of foreign laws and regulations,
- unexpected changes in regulatory requirements, and
- new tariffs or other barriers to some international markets.

We are also subject to general political and economic risks associated with conducting international business, including:

- political instability,
- changes in diplomatic and trade relationships, and
- general economic fluctuations in specific countries or markets.

We cannot predict whether quotas, duties, taxes, or other similar restrictions will be imposed by the United States, Mexico, the European Union, Canada, China, Japan, India, Korea or other countries upon the import or export of our products in the future, or what effect any of these actions would have on our business, financial condition or results of operations. Changes in regulatory or geopolitical policies and other factors may adversely affect our business in the future or may require us to modify our current business practices.

We face intense competition in the denim industry.

We face a variety of competitive challenges from other domestic and foreign fashion-oriented apparel producers, some of whom may be significantly larger and more diversified and have greater financial and marketing resources than we have. We do not currently hold a dominant competitive position in any market. We compete with other denim manufacturers such as Seven for All Mankind, Citizens of Humanity and Rock & Republic, and other larger competitors primarily on the basis of:

- anticipating and responding to changing consumer demands in a timely manner,
- maintaining favorable brand recognition,
- developing innovative, high-quality products in sizes, colors and styles that appeal to consumers,
- appropriately pricing products,
- providing strong and effective marketing support,
- creating an acceptable value proposition for retail customers,
- ensuring product availability and optimizing supply chain efficiencies with manufacturers and retailers, and
- obtaining sufficient retail floor space and effective presentation of our products at retail.

Furthermore, some of our competitors are privately held corporations and may have resources available to them that we, as a public company do not have. Therefore, it may be difficult for us to effectively gauge consumer response to our products and how our products are competing with these and other competitors in the marketplace.

In the event that we consummate the merger agreement with JD Holdings, our existing stockholders may be diluted.

Pursuant to the merger agreement entered into in February 2007 with JD Holdings, if we receive approval by our stockholders, we have agreed to issue to JD Holdings 14,000,000 shares of our common stock. In the event that we issue 14,000,000 shares of our common stock, this issuance would dilute the equity interests of our existing stockholders. The perceived risk of dilution may cause our existing stockholders to sell their shares, which could contribute to a decline in the price of our common stock or to vote against the merger transaction. In the event that the merger is not approved by our stockholders, we would continue to hold only a license for the right to use the Joe s® brand and marks.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 2. PROPERTIES

Our principal place of business is located in Commerce, Los Angeles County, California. The following table sets forth information with respect to our principal place of business:

Location	Use	Ownership Status	Approximate Area in Square Feet	Lease Expiration
Commerce, California	Design and administrative offices	Leased	15,000 sq. ft.	Verbal arrangement

We believe that our existing facilities are well maintained, in good operating condition and are adequate for our present level of operations. In addition, our Joe s products are displayed in third-party showrooms in New York City, Los Angeles and internationally through sales representation or distribution arrangements. Therefore, we do not lease or own space in which Joe s products are sold in the United States or internationally. We also have leased a small office space in New York, New York for public relations purposes that we lease on a short term lease that is renewable for consecutive six month periods.

Historically, we have at times leased additional space to meet certain needs associated with other divisions, business lines or business segments that we no longer operate. For example, we previously leased additional executive office space in Los Angeles, California since our prior principal office space did not have a meeting room for our board and management. In addition, we also leased space in New York, New York in connection with the launch and support of our Fetish and Shago® branded apparel lines. We have entered into a sublease and an assignment of leases for these spaces, respectively; however, we remain contingently liable as the original lessee under the lease agreements until the end of the original term of the subleases, which are December 31, 2009 and July 31, 2009, respectively. The chances are remote that we will be required to pay any additional amounts under these guarantees.

ITEM 3. LEGAL PROCEEDINGS

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

(b) None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

(a) Our common stock is currently traded under the symbol INNO on The Nasdaq Capital Market maintained by The Nasdaq Stock Market, Inc., or Nasdaq. The following sets forth the high and low interday quotations for our common stock in such market for the periods indicated. This information reflects inter-dealer prices, without retail mark-up, mark-down or commissions, and may not necessarily represent actual transactions. No representation is made by us that the following quotations necessarily reflect an established public trading market in our common stock:

Fiscal 2006	High	Low
First Quarter	$ 1.41	$ 0.50
Second Quarter	$ 1.32	$ 0.52
Third Quarter	$ 0.85	$ 0.45
Fourth Quarter	$ 0.75	$ 0.37

Fiscal 2005	High	Low
First Quarter	$ 4.79	$ 1.96
Second Quarter	$ 6.61	$ 3.93
Third Quarter	$ 6.24	$ 1.88
Fourth Quarter	$ 2.38	$ 1.12

As of February 6, 2007, there were 909 record holders of our common stock.

We have never declared or paid a cash dividend and do not anticipate paying cash dividends on our common stock in the foreseeable future. In deciding whether to pay dividends on our common stock in the future, our board of directors will consider such factors they may deem relevant, including our earnings and financial condition and our capital expenditure requirements.

Equity Compensation Plan Information

The following table sets forth certain information about our common stock that may be issued upon the exercise of options, warrants and rights under all of the our compensation plans (including individual compensation arrangements) under which our equity securities are authorized for issuance as of November 25, 2006, which includes our 2004 Stock Incentive Plan, our 2000 Employee Stock Incentive Plan and our 2000 Director Stock Incentive Plan. We stopped granting options under our 2000 Employee Stock Incentive Plan or our 2000 Director Stock Incentive Plan after the adoption and approval of our 2004 Stock Incentive Plan on June 3, 2004.

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 Issuance Under Equity Compensation Plan (excluding securities reflected in column (a)) (c)
Equity Compensation Plans approved by security			