

BLUEFLY INC  
Form 10-K  
March 05, 2009

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-K

ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2008

OR

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

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

Commission File Number 000-24821

BLUEFLY, INC.

(Name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of  
incorporation or organization)

13-3612110

(I.R.S. Employer Identification Number)

42 West 39th Street, New York, NY  
(Address of principal executive offices)

10018  
(Zip Code)

Registrant's telephone number: (212) 944-8000

Securities registered pursuant to Section 12(b) of the Securities Exchange Act of 1934:

Title of each class	Name of Exchange on Which Registered
Common stock, par value \$.01 per share	The Nasdaq Stock Market LLC

Securities registered under Section 12(g) of the Exchange Act: None

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

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  No

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

Indicate by check mark whether disclosure of delinquent filers in response to Item 405 of Regulation S-K is not contained in this form, and will not be contained, to the best of the 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.

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
(Do not check if a smaller reporting company)

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

As of February 27, 2009, there were 18,831,950 shares of Common Stock, \$.01 par value, of the registrant outstanding. The aggregate market value of the voting and non-voting common equity held by non-affiliates as of June 30, 2008, based upon the last sale price of such equity reported on the Nasdaq Capital Market, was approximately \$8.3 million.

DOCUMENTS INCORPORATED BY REFERENCE

Certain information required by Part III of Form 10-K is incorporated by reference to the Registrant’s proxy statement for the 2009 Annual Stockholders Meeting, which will be filed with the Securities and Exchange Commission.

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## BLUEFLY, INC.

## ANNUAL REPORT ON FORM 10-K

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## PART I.

### Special Note Regarding Forward-Looking Statements and Associated Risks

This Annual Report contains "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. 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," "project," "will be," "will continue," "will likely" or words or phrases of similar meaning. Forward-looking statements involve risks and uncertainties that may cause actual results to differ materially from the forward-looking statements ("Cautionary Statements"). The risks and uncertainties include, but are not limited to those matters addressed herein under "Risk Factors." All subsequent written and oral forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the Cautionary Statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of their dates. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

### Item 1. Business

#### General

Bluefly, Inc. is a leading online retailer of designer brands, fashion trends and superior value. During 2008, we offered over 50,000 different styles for sale in categories such as men's, women's and accessories as well as house and home accessories from over 350 brands at discounts up to 75% off retail value. We launched the Bluefly.com Web site (the "Web site") in September 1998. Since its inception, www.bluefly.com has served over one million customers and shipped to over 13 countries.

Our common stock is listed on the Nasdaq Capital Market under the symbol "BFLY" and we are incorporated in the state of Delaware. Our executive offices are located at 42 West 39th Street, New York, New York 10018, and our telephone number is (212) 944-8000. Our Internet address is www.bluefly.com. We make available, free of charge, through our Web site, our annual report on Form 10-K, 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 Exchange Act as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission (the "SEC").

In this report, the terms "we," "us," "Bluefly" and the "Company" refer to Bluefly, Inc. and its predecessors and subsidiaries, unless the context indicates otherwise.

#### Business Strategy

Our goal is to offer our customers the best designer brands and latest fashion trends at superior values. We offer the same types of on-trend and in-season designer merchandise as are sold in luxury department stores at discounted prices. Similarly, we are able to offer an upscale shopping experience not available at off-price stores or outlet malls because of our merchandise selection and the presentation and product search capabilities offered by our site. The frequent addition of new on-trend products to our Web site is also one of the key factors to our marketing strategy, as it gives our shoppers reason to visit the site and encourages them to be loyal and active.

Our business is also designed to provide a compelling value proposition for our suppliers and, in particular, the more than 350 top designer brands that we offer on our Web site. Because we work with our suppliers both at the beginning and throughout the season, we are able to help them manage inventory and cash flow. We also create an environment

that is respectful of the brands we sell. Our buyers all have backgrounds in a full price branded retail environment. Our Web site creates a high-end retail environment that offers only the best designer brands and the most current trends. In doing so, we support our vendors' brands, rather than diluting them as traditional off-price channels do.

We do not believe that we can accomplish these goals without using the Internet as a platform. The direct marketing of products that are available in limited quantities and sizes, and that are not replenishable, requires a cost-effective medium that can display a large number of products. We believe print catalogs are not well suited to this task. The paper, printing, mailing and other production costs of a print catalog can be significant and the lead times required to print a catalog make them significantly inflexible in addressing inventory sell outs, price changes and new styles. To work around these limitations, a traditional cataloger typically requires products that are replenishable, available in a full range of sizes and in substantial quantities. Similarly, retailing on television is costly and requires substantial quantities of products that are available in all sizes in order for it to be an economical medium. In addition, the number of items that can be displayed on television is limited, and television does not allow viewers to search for products that interest them.

The Internet, however, can be a far less expensive and far more effective medium. By using the Internet as our platform, the number of items that we offer is not limited by the high costs of printing and mailing catalogs. With the Internet, we can automatically update

product images as new products arrive and other items sell out. By using a real-time inventory database, we can create a personalized shopping environment and allow our customers to search for the products that specifically interest them and are available in their size. In addition, we believe that we are able to more economically and consistently maintain an upscale environment through the design of a single online storefront.

We believe that we have created a customer experience that is fundamentally better than that offered by traditional off-price retailers. Similarly, we believe that our upscale atmosphere, professional photography and premium merchandise offering create a superior distribution channel for designers who wish to liquidate their end-of-season and excess merchandise without suffering the brand dilution inherent in traditional off-price channels. Our customer research suggests that this strategy has been successful.

#### E-Commerce And The Online Apparel Market

The continued growth of e-commerce has been widely reported. According to projections published by Forrester Research, Inc., U.S. online retail sales are expected to rise 11% to \$156 billion this year. Online sales are expected to make up 6% of overall retail revenue in 2009, compared with 5% in 2008.

#### Marketing

Our marketing efforts are focused both on acquiring new customers and retaining existing customers. Active Bluefly customers visit the site frequently and purchase from one season to the next at high levels with great predictability. A significant portion of our sales to existing customers are driven by our customer emails, which highlight new promotions and products, and provide special previews to customers who have asked to be included in our email list. In addition, we believe that our sales to existing customers are driven by all aspects of our customer experience, including our Web site design, packaging, delivery and customer service.

Prior to 2005, we acquired new customers primarily through online advertising, word-of-mouth, sweepstakes and our affiliate program. In September 2005, faced with low awareness numbers, we began a national advertising campaign that featured both print and television. Over the past three and a half years we have increased awareness by targeting general advertising efforts to a more fashion focused customer. Over the past two years we further refined our marketing strategy by aligning ourselves with entertainment properties, such as BravoTV.com, Project Runway, Bride Wars and Confessions of a Shopaholic.

#### Merchandising

We buy merchandise directly from designers as well as from other third party indirect resources. Currently, we offer products from more than 350 name brand designers. We believe that we have been successful in developing vendor relationships, in part because we have devoted substantial resources to establishing Bluefly.com as a high-end retail environment. We are committed to displaying all of our merchandise in an attractive manner, offering superior customer service and gearing all aspects of our business towards creating a better channel for top designers.

#### Warehousing And Fulfillment

When we receive an order, the information is transmitted to our third party warehouse and fulfillment center located in Ohio, where the items included in the order are picked, packed and shipped directly to the customer. Our inventory database is updated on a real-time basis, allowing us to display on our Web site only those styles, sizes and colors of product available for sale.

We focus on customer satisfaction throughout our organization. In December 2008, during our peak weeks of the holiday season, the vast majority of our orders were shipped within one business day from receipt of the customer's order.

#### Customer Service

We believe that a high level of customer service and support is critical to differentiating ourselves from traditional off-price retailers and maximizing customer acquisition and retention efforts. Our customer service effort starts with our Web site, which is designed to provide an intuitive shopping experience. An easy-to-use help center is available on the Web site and is designed to answer many of our customers' most frequently asked questions. For customers who prefer e-mail, chat or telephone assistance, customer service representatives are available seven days a week to provide assistance. We utilize customer representatives from a third party call center that has a team dedicated to our business. We also maintain a supervisor in our New York office, who provide special services and assist in the training and management of the other representatives. To ensure that customers are satisfied with their shopping experience, we generally allow returns for any reason within 90 days of the sale for a full refund.

In November 2008 we were awarded the "International Service Excellence Award" from the International Council of Customer Service Organizations. This award recognizes customer service excellence in management systems worldwide. We were also awarded the "E-tailing Excellence Award" from the e-tailing group in January 2007 for the second consecutive year. This award recognizes online merchants who excel in customer service.



## Technology

We have implemented a broad array of state-of-the-art technologies that facilitate Web site management, complex database search functionality, customer interaction and personalization, transaction processing, fulfillment and customer service functionality. Such technologies include a combination of proprietary technology and commercially available, licensed technology. To address the critical issues of privacy and security on the Internet, we incorporate, for transmission of confidential personal information between customers and our Web server, Secure Socket Layer Technology such that all data is transmitted via a 128-bit encrypted session. The computer and communications equipment on which our Web site is hosted are currently located at a third party co-location facility in New York.

We have developed a new version of our Web site, using certain technology of the Art Technology Group, Inc., which was placed into service in August 2008. We expect that the more robust tools provided by the upgraded Web site will allow us to better create and manage, and measure the performance of, on-site marketing promotions. In addition, we believe that the new Web site will provide a more efficient platform from which to scale our technology infrastructure should any future growth in our business dictate such a need.

## Competition

E-commerce generally, and, in particular, the online retail apparel and fashion accessories market, is a relatively dynamic, high-growth market. Our competition for online customers comes from a variety of sources, including existing land-based retailers that are using the Internet to expand their channels of distribution, established Internet companies and less established companies. In addition, our competition for customers comes from traditional direct marketers, designer brands that may attempt to sell their products directly to consumers through the Internet and land-based off-price retail stores, which may or may not use the Internet in the future to grow their customer base. Many of these competitors have longer operating histories, significantly greater resources, greater brand recognition and more firmly established supply relationships. Moreover, we expect additional competitors to emerge in the future.

We believe that the principal competitive factors in our market include: brand recognition, merchandise selection, price, convenience, customer service, order delivery performance and site features.

## Intellectual Property

We rely on various intellectual property laws and contractual restrictions to protect our proprietary rights in services and technology, including confidentiality, invention assignment and nondisclosure agreements with employees and contractors. Despite these precautions, it may be possible for a third party to copy or otherwise obtain and use our intellectual property without our authorization. In addition, we pursue the registration of our trademarks and service marks in the U.S. and internationally and the registration of our domain name and variations thereon. However, effective intellectual property protection may not be available in every country in which the services are made available online.

We also rely on technologies that we license from third parties. These licenses may not continue to be available to us on commercially reasonable terms in the future. As a result, we may be required to obtain substitute technology of lower quality or at greater cost, which could materially adversely affect our business, financial condition, results of operations and cash flows.

We do not believe that our business, sales policies or technologies infringe the proprietary rights of third parties. However, third parties have in the past and may in the future claim that our business, sales policies or technologies infringe their rights. We expect that participants in the e-commerce market will be increasingly subject

to infringement claims as the number of services and competitors in the industry grows. Any such claim, with or without merit, could be time consuming, result in costly litigation or require us to enter into royalty or licensing agreements. Such royalty or licensing agreements might not be available on terms acceptable to us, or at all. As a result, any such claim of infringement against us could have a material adverse effect upon our business, financial condition, results of operations and cash flows.

#### Governmental Approvals And Regulations

We are not currently subject to direct regulation by any domestic or foreign governmental agency, other than regulations applicable to businesses generally, and laws or regulations directly applicable to online commerce. We are not aware of any permits or licenses that are required in order for us, generally, to sell apparel and fashion accessories on the Internet, although licenses are sometimes required to sell products made from specific materials. In addition, permits or licenses may be required from international, federal, state or local governmental authorities to operate or to sell certain other products on the Internet in the future. No assurances can be given that we will be able to obtain such permits or licenses. We may be required to comply with future national and/or international legislation and statutes regarding conducting commerce on the Internet in all or specific countries throughout the world. No assurance can be made that we will be able to comply with such legislation or statutes. Our Internet operations are not currently impacted by federal, state, local and foreign environmental protection laws and regulations.

## Seasonality And Fashion Trends

Our business is affected by seasonality, which historically has resulted in higher sales volume during our fourth quarter, which ends December 31. We recognized 29%, 33% and 35% of our annual revenue during the fourth quarter of 2008, 2007 and 2006, respectively. In addition, our business fluctuates according to changes in customer preferences dictated in part by fashion trends. The cyclical nature of our business requires us to carry a significant amount of inventory, especially prior to peak selling seasons when we generally build up our inventory levels. As a result, we are vulnerable to demand and pricing shifts and to errors in selection and timing of merchandise purchases.

## Employees

As of February 27, 2009, we had 87 full-time employees and 1 part-time employee, as compared to 102 full-time employees and 3 part-time employees as of February 27, 2008. None of our employees are represented by a labor union, and we consider our relations with our employees to be good.

## Item 1A. Risk Factors

**We Have A History Of Losses And Expect That Losses Will Continue In The Future.** As of December 31, 2008, we had an accumulated deficit of \$143,878,000. We incurred net losses of \$11,340,000, \$15,829,000 and \$12,193,000 for the years ended December 31, 2008, 2007 and 2006, respectively. During the year ended December 31, 2008, net cash used in operating activities was \$3.2 million. We have incurred negative cash flows and net losses since inception. Although we have experienced revenue growth in recent years, this growth should not be considered indicative of future performance, particularly given the challenging environment that we now face.

We believe that we have sufficient liquidity from current funds and operating cash flow despite the disruption of the capital markets and the continued decline in economic conditions. Moreover, we believe that our existing cash balance, combined with working capital, will be sufficient to enable us to meet planned expenditures under a streamlined business plan through at least the next 12 months. The streamlined business plan calls for, among other things, reductions in marketing and capital expenditures, delaying new hires and making selective inventory purchases.

In addition, should we experience unforeseen increases in expenditures or should estimated revenues not materialize, these conditions could significantly impair our ability to fund future operations. Should we experience unanticipated losses or expenditures that exceed current estimates, management would implement a cost reduction plan, that includes a reduction in work force as well as reductions in overhead costs and capital expenditures, and/or attempt to raise additional debt or equity financing. There can be no assurance that we will achieve or sustain positive cash flows from operations or profitability. If we are unable to maintain adequate liquidity, future operations will need to be scaled back or discontinued.

**Soros, Maverick And Prentice Each Own A Large Amount Of Our Stock And Therefore Can Exert Significant Influence Over Our Management And Policies.** As of February 27, 2009, affiliates of Soros Fund Management L.L.C (“Soros”) owned approximately 36% of our Common Stock and private funds associated with Maverick Capital, Ltd. (“Maverick”) and investment entities and accounts managed and advised by Prentice Capital Management, LP (“Prentice”) each owned approximately 22% of our Common Stock. We are parties to a voting agreement with Soros, Maverick and Prentice (the “Voting Agreement”), pursuant to which Soros has the right to designate three designees to our Board of Directors, and Maverick and Prentice each have the right to designate one designee. The Voting Agreement also provides that one designee of Soros and the designee of each of Maverick and Prentice have the right to serve on the Compensation Committee and the Governance and Nominating Committee of the Board of Directors. If we establish an Executive Committee, the designees of Soros, Maverick and Prentice will be entitled to serve on such committee.

In view of their large percentage of ownership, Soros, Maverick and Prentice each have the ability to exert significant influence over our management and policies, such as the election of our directors, the appointment of new management and the approval of any other action requiring the approval of our stockholders, including any amendments to our certificate of incorporation, a sale of all or substantially all of our assets or a merger.

The Deterioration in the Global Economic Environment, and Resulting Declines in Consumer Confidence and Spending, Will Have an Adverse Effect on Our Operating Results. The global economic environment deteriorated substantially during 2008. The declining values in real estate, reduced credit lending by banks, solvency concerns of major financial institutions, increases in unemployment levels and recent significant declines and volatility in the global financial markets have negatively impacted the level of consumer spending for discretionary items. This has affected our business as it is dependent on consumer demand for our products. As a result, during the fourth quarter of 2008, our revenues declined by approximately 8%, compared to the fourth quarter of 2007 as this is a highly promotional environment. If the global economic environment continues to be weak or deteriorates further, there will likely be a negative effect on our revenues and earnings for the remainder of the current fiscal year and continuing into fiscal 2010.

Our Stock May Be Delisted From Nasdaq, Which May Adversely Affect Our Ability To Raise Capital and Stockholders Ability To Sell Their Shares. Under Nasdaq Marketplace Rule 4310(c)(4) requirement, if the bid price of the Company's common stock closes below the minimum \$1.00 per share for 30 consecutive business days, the Company's common stock is subject to potential delisting from the Nasdaq Capital Market. Given the extraordinary market conditions, Nasdaq has suspended this requirement until April 20, 2009. The bid price of the Company's common stock has closed below \$1.00 for 30 consecutive business days so the Company could be subject to potential delisting if the stock stays below \$1.00 and the requirement is reinstated. In that case, the Company would be given 180 calendar days, to regain compliance by maintaining a bid price of at least \$1.00 for 10 consecutive business days.

We Will Operate Under a Streamlined Business Plan Unless We Are Able To Raise Additional Funds. Our ability to meet our obligations in the ordinary course of business is dependent upon our ability to establish profitable operations or raise additional financing through public or private debt or equity financing, or other sources of financing to fund operations. The disruption of the capital markets and the continued decline in economic conditions negatively impacts our ability to raise additional financing, and, accordingly, we have developed a streamlined operating plan, which we intend to pursue unless and until additional capital becomes available on acceptable terms. We believe that our existing cash balance, combined with working capital, and our availability under our existing credit facility, will be sufficient to enable us to meet our planned expenditures under this streamlined business plan through at least the next 12 months. The streamlined business plan calls for, among other cost cutting measures, reductions in marketing and capital expenditures, delaying new hires and being more selective in inventory purchases. However, in order to optimize the growth of our business, we will need to seek to raise additional debt or equity financing. There can be no assurance that we will be able to identify a source of such financing, or that such financing will be available on terms acceptable to us. Moreover, should the opportunity to raise additional capital arise, any additional debt or equity financing could result in significant dilution of the existing holders of common stock.

Our Lender Has Liens On Substantially All Of Our Assets And Could Foreclose In The Event That We Default Under Our Credit Facility. Under the terms of our credit facility, our lender has a first priority lien on substantially all of our assets, including our cash balances. If we default under the credit facility, our lender would be entitled to, among other things, foreclose on our assets (whether inside or outside a bankruptcy proceeding) in order to satisfy our obligations under the credit facility.

Our Ability To Maintain And Pay Our Indebtedness Under Our Credit Facility Is Dependent Upon Meeting Our Business Plan. We are required to pay interest under our credit facility on a monthly basis. Assuming we meet our business plan, we will be able to pay our interest as required. To a certain extent, however, our ability to meet our business plan, is subject to general economic, financial, competitive, legislative, regulatory and other factors that are beyond our control, and therefore we cannot assure you that based on our business plan we will generate sufficient cash flow from operations to enable us to pay our indebtedness under the credit facility and maintain our minimum availability requirement throughout the term of the agreement. If we fall short of our business plan and are unable to raise additional capital, we could default under our credit facility. In the event of a default under the credit facility, our lender would be entitled, among other things, to foreclose on our assets (whether inside or outside a bankruptcy proceeding) in order to satisfy our obligations under the credit facility. See "Risk Factors – Our Lenders Have Liens On Substantially All Of Our Assets And Could Foreclose In The Event That We Default Under Our Credit Facility."

If We Are Not Accurate In Forecasting Our Revenues, We May Be Unable To Adjust Our Operating Plans In A Timely Manner. Because our business has not yet reached a mature stage, it is difficult for us to forecast our revenues accurately. We base our current and future expense levels and operating plans on expected revenues, but in the short-term a significant portion of our expenses are fixed. Accordingly, we may be unable to adjust our spending in a timely manner to compensate for any unexpected revenue shortfall. This inability could cause our operating results in some future quarter to fall below the expectations of securities analysts and investors. In that event, the trading price of our Common Stock could decline significantly. In addition, any such unexpected revenue shortfall could

significantly affect our short-term cash flow and our net worth, which could require us to seek additional financing and/or cause a default under our credit facility. See “Risk Factors – Our Ability To Maintain And Pay Our Indebtedness Under Our Credit Facility Is Dependent Upon Meeting Our Business Plan.”

Our National Advertising Campaign and Other Marketing Initiatives May Not Be Successful. Our success depends on our ability to attract customers on cost-effective terms. We have relationships with online services, search engines, and other Web sites and e-commerce businesses to provide other links that direct customers to our Web site. In addition, during 2005 we launched our first national television and advertising campaign, and we have continued and expanded on that campaign since that time. Such campaigns are expensive and may not result in the cost effective acquisition of customers. We are relying on the campaign as a source of traffic to our Web site and new customers. If these campaigns and initiatives are not successful, our results of operations will be adversely affected.

We Purchase a Substantial Portion of Our Inventory from One Supplier. In 2008 and 2007, we purchased approximately 31% and 38%, respectively, of our inventory from one supplier. Should our relationship with this supplier deteriorate or terminate, or should this supplier lose some or all of its access to the products that we purchase from it, our performance could be adversely affected. Under such

circumstances, we would be required to seek alternative sources of supply for these products, and there can be no assurance that we would be able to obtain such products from alternative sources on the same terms, or at all. A failure to obtain such products on as favorable terms could have an adverse effect on our revenue and/or gross margin.

**We Do Not Have Long Term Contracts With Our Vendors And Therefore The Availability Of Merchandise Is At Risk.** We do not have any agreements controlling the long-term availability of merchandise or the continuation of particular pricing practices. Our contracts with suppliers typically do not restrict such suppliers from selling products to other buyers. There can be no assurance that our current suppliers will continue to sell products to us on current terms or that we will be able to establish new or otherwise extend current supply relationships to ensure product acquisitions in a timely and efficient manner and on acceptable commercial terms. In addition, in order to entice new vendors to open up relationships with us, we sometimes are required to either make prepayments or agree to shortened payment terms. Our ability to develop and maintain relationships with reputable suppliers and obtain high quality merchandise is critical to our success. If we are unable to develop and maintain relationships with suppliers that would allow us to obtain a sufficient amount and variety of quality merchandise on acceptable commercial terms, our ability to satisfy our customers' needs, and therefore our long-term growth prospects, would be materially adversely affected. See "Risk Factors - Brand Owners Could Establish Procedures to Limit Our Ability to Purchase Products Indirectly" and "Risk Factors – We Purchase a Substantial Portion of Our Inventory from One Supplier."

**Unexpected Changes In Fashion Trends Could Cause Us To Have Either Excess or Insufficient Inventory.** Fashion trends can change rapidly, and our business is sensitive to such changes. There can be no assurance that we will accurately anticipate shifts in fashion trends and adjust our merchandise mix to appeal to changing consumer tastes in a timely manner. If we misjudge the market for our products or are unsuccessful in responding to changes in fashion trends or in market demand, we could experience insufficient or excess inventory levels or higher markdowns, either of which would have a material adverse effect on our business, financial condition and results of operations.

**We Will Be Subject To Cyclical Variations In The Apparel And E-Commerce Markets.** The apparel industry historically has been subject to substantial cyclical variations. The recent economic downturn has effected retailers especially hard. The National Retail Federation, a retail trade association, recently announced that it forecasts a 0.5% decline in retail sales for 2009. Furthermore, Internet usage slows down in the summer months. We and other apparel vendors rely on the expenditure of discretionary income for most, if not all, sales. Economic downturns, whether real or perceived, in economic conditions or prospects could adversely affect consumer spending habits and, therefore, have a material adverse effect on our revenue, cash flow and results of operations. Alternatively, any improvement, whether real or perceived, in economic conditions or prospects could adversely impact our ability to acquire merchandise and, therefore, have a material adverse effect on our business, prospects, financial condition and results of operations, as our supply of merchandise is dependent on the inability of designers and retailers to sell their merchandise in full-price venues. See "Risk Factors – We Do Not Have Long Term Contracts With Our Vendors And Therefore The Availability of Merchandise Is At Risk."

**We Purchase Product From Some Indirect Supply Sources, Which Increases Our Risk of Litigation Involving The Sale Of Non-Authentic Or Damaged Goods.** We purchase merchandise both directly from brand owners and indirectly from retailers and third party distributors. The purchase of merchandise from parties other than the brand owners increases the risk that we will mistakenly purchase and sell non-authentic or damaged goods, which could result in potential liability under applicable laws, regulations, agreements and orders. Moreover, any claims by a brand owner, with or without merit, could be time consuming, result in costly litigation, generate bad publicity for us, and have a material adverse impact on our business, prospects, financial condition and results of operations.

**Security Breaches To Our Systems And Database Could Cause Interruptions to Our Business And Impact Our Reputation With Customers, And We May Incur Significant Expenses to Protect Against Such Breaches.** A fundamental requirement for online commerce and communications is the secure transmission of confidential

information over public networks. There can be no assurance that advances in computer capabilities, new discoveries in the field of cryptography, or other events or developments will not result in a compromise or breach of the algorithms we use to protect customer transaction and personal data contained in our customer database. A party who is able to circumvent our security measures could misappropriate proprietary information or cause interruptions in our operations. If any such compromise of our security were to occur, it could have a material adverse effect on our reputation with customers, thereby affecting our long-term growth prospects. In addition, we may be required to expend significant capital and other resources to protect against such security breaches or to alleviate problems caused by such breaches.

**Brand Owners Could Establish Procedures To Limit Our Ability To Purchase Products Indirectly.** Brand owners have implemented, and are likely to continue to implement, procedures to limit or control off-price retailers' ability to purchase products indirectly. In addition, several brand owners in the U.S. have distinctive legal rights rendering them the only legal importer of their respective brands into the U.S. If we acquire such product indirectly from distributors and other third parties who may not have complied with applicable customs laws and regulations, such goods could be subject to seizure from our inventory by U.S. Customs



Service, and the importer may have a civil action for damages against us. See “Risk Factors - We Do Not Have Long Term Contracts With Our Vendors And Therefore The Availability Of Merchandise Is At Risk.”

**We Are Heavily Dependent On Third-Party Relationships, And Failures By A Third Party Could Cause Interruptions To Our Business.** We are heavily dependent upon our relationships with our fulfillment operations provider, third party call center and Web hosting provider, delivery companies like UPS and the United States Postal Service, and credit card processing companies such as Paymentech and Cybersource to service our customers' needs. To the extent that there is a slowdown in mail service or package delivery services, whether as a result of labor difficulties, terrorist activity or otherwise, our cash flow and results of operations would be negatively impacted during such slowdown, and the results of such slowdown could have a long-term negative effect on our reputation with our customers. The failure of our fulfillment operations provider, third party call center, credit card processors or Web hosting provider to properly perform their services for us could cause similar effects. Our business is also generally dependent upon our ability to obtain the services of other persons and entities necessary for the development and maintenance of our business. If we fail to obtain the services of any such person or entities upon which we are dependent on satisfactory terms, or we are unable to replace such relationship, we would have to expend additional resources to develop such capabilities ourselves, which could have a material adverse impact on our short-term cash flow and results of operations and our long-term prospects.

**We Are In Competition With Companies Much Larger Than Ourselves.** E-commerce generally and, in particular, the online retail apparel and fashion accessories market, is a dynamic, high-growth market and is rapidly changing and intensely competitive. Our competition for customers comes from a variety of sources including: