

Edgar Filing: BLUEFLY INC - Form 10-Q

BLUEFLY INC
Form 10-Q
August 13, 2008

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

FORM 10-Q

(Mark One)

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2008

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

Commission File Number: 001-14498

BLUEFLY, INC.
(Exact name of registrant as specified in its charter)

Delaware 13-3612110
(State or other jurisdiction of (I.R.S. Employer Identification No.)
incorporation or organization)

42 West 39th Street, New York, NY 10018
(Address of principal executive offices) (Zip Code)

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

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 the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large 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

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

As of August 12, 2008, the issuer had outstanding 13,287,437 shares of Common Stock, \$.01 par value.

BLUEFLY, INC.
TABLE OF CONTENTS

Edgar Filing: BLUEFLY INC - Form 10-Q

	PAGE

Part I. Financial Information	
Item 1. Financial Statements	
Condensed Balance Sheets as of June 30, 2008 (unaudited) and December 31, 2007	3
Condensed Statements of Operations for the six months ended June 30, 2008 and 2007 (unaudited)	4
Condensed Statements of Operations for the three months ended June 30, 2008 and 2007 (unaudited)	5
Condensed Statements of Cash Flows for the six months ended June 30, 2008 and 2007 (unaudited)	6
Condensed Notes to Financial Statements (unaudited)	7
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	11
Item 3. Quantitative and Qualitative Disclosures About Market Risk	17
Item 4T. Controls and Procedures	17
Part II. Other Information	18
Item 1. Legal Proceedings	18
Item 4. Submission of Matters to a Vote of Security Holders	18
Item 6. Exhibits	19
Signatures	20

2

Part I - FINANCIAL INFORMATION
Item 1. - Financial Statements

BLUEFLY, INC.

CONDENSED BALANCE SHEETS (Unaudited)

	June 30, 2008

ASSETS	
Current assets	
Cash and cash equivalents	\$2,591,000
Inventories, net	25,255,000
Accounts receivable, net of allowance for doubtful accounts	2,492,000

Edgar Filing: BLUEFLY INC - Form 10-Q

Prepaid inventory	106,000	
Prepaid expenses	832,000	
Other current assets	652,000	

Total current assets	31,928,000	
Property and equipment, net	6,784,000	
Other assets	190,000	

Total assets	\$38,902,000	=====
Current liabilities		
Accounts payable	\$7,615,000	
Allowance for sales returns	3,342,000	
Accrued expenses and other current liabilities	1,352,000	
Deferred revenue	2,732,000	

Total current liabilities	15,041,000	
Other long-term obligations	--	

Total liabilities	\$15,041,000	-----
Commitments and contingencies		
Shareholders' equity		
Series F Preferred stock - \$.01 par value; 7,000 shares authorized, 571.43 issued and outstanding as of June 30, 2008 and December 31, 2007 (liquidation preference: \$571,000 plus accrued dividends of \$127,000, and \$105,000 as of June 30, 2008 and December 31, 2007, respectively)		--
Common stock - \$.01 par value; 200,000,000 shares authorized as of June 30, 2008 and December 31, 2007, respectively, 13,434,653 and 13,426,803 shares issued as of June 30, 2008 and December 31, 2007, respectively, 13,278,103 and 13,275,730 shares outstanding as of June 30, 2008 and December 31, 2007, respectively	1,328,000	
Treasury Stock	(1,452,000)	
Additional paid-in capital	160,785,000	
Accumulated deficit	(136,800,000)	

Total shareholders' equity	23,861,000	

Total liabilities and shareholders' equity	\$ 38,902,000	=====

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

3

BLUEFLY, INC.
CONDENSED STATEMENTS OF OPERATIONS
(Unaudited)

Six Months Ended
June 30,

2008 2007

Edgar Filing: BLUEFLY INC - Form 10-Q

	-----	-----
Net sales	\$48,579,000	\$43,716,000
Cost of sales	30,545,000	26,879,000
	-----	-----
Gross profit	18,034,000	16,837,000
Selling and fulfillment expenses	9,592,000	8,945,000
Marketing expenses	6,448,000	6,323,000
General and administrative expenses	6,837,000	7,040,000
	-----	-----
Total operating expenses	22,877,000	22,308,000
Operating loss	(4,843,000)	(5,471,000)
Interest income	49,000	364,000
Interest expense	(180,000)	(138,000)
	-----	-----
Net loss	\$ (4,974,000)	\$ (5,245,000)
Preferred stock dividends	(22,000)	(22,000)
Net loss available to common shareholders	\$ (4,996,000)	\$ (5,267,000)
	=====	=====
Basic and diluted loss per common share	\$ (0.38)	\$ (0.40)
	=====	=====
Weighted average common shares outstanding (basic and diluted)	13,259,059	13,049,986
	=====	=====

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

4

BLUEFLY, INC.
CONDENSED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended June 30,	
	-----	-----
	2008	2007
	-----	-----
Net sales	\$23,334,000	\$21,608,000
Cost of sales	14,236,000	13,145,000
	-----	-----
Gross profit	9,098,000	8,463,000
Selling and fulfillment expenses	4,523,000	4,546,000
Marketing expenses	2,926,000	2,712,000
General and administrative expenses	3,590,000	3,454,000
	-----	-----
Total operating expenses	11,039,000	10,712,000
Operating loss	(1,941,000)	(2,249,000)

Edgar Filing: BLUEFLY INC - Form 10-Q

Interest income	13,000	169,000
Interest expense	(108,000)	(62,000)
	-----	-----
Net loss	\$ (2,036,000)	\$ (2,142,000)
Preferred stock dividend	(11,000)	(11,000)
Net loss available to common shareholders	\$ (2,047,000)	\$ (2,153,000)
	=====	=====
Basic and diluted loss per common share	\$ (0.15)	\$ (0.16)
	=====	=====
Weighted average common shares outstanding (basic and diluted)	13,269,123	13,050,889
	=====	=====

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

5

BLUEFLY, INC.
CONDENSED STATEMENTS OF CASH FLOWS
(Unaudited)

	Six Months June

	2008

Cash flows from operating activities	
Net loss	\$ (4,974,000)
Adjustments to reconcile net loss to net cash used in operating activities:	
Depreciation and amortization	903,000
Stock based compensation	1,647,000
Provisions for returns	(862,000)
Bad debt expense	308,000
Reserve for inventory obsolescence	200,000
Changes in operating assets and liabilities:	
(Increase) decrease in	
Inventories	3,037,000
Accounts receivable	(698,000)
Prepaid expenses	133,000
Other current assets	(307,000)
Other assets	(35,000)
Increase (decrease) in	
Accounts payable and other long-term liabilities	(905,000)
Accrued expenses and other current liabilities	(678,000)
Deferred revenue	(474,000)

Net cash used in operating activities	(2,705,000)

Cash flows from investing activities	
Purchase of property and equipment	(1,585,000)

Net cash used in investing activities	(1,585,000)

Edgar Filing: BLUEFLY INC - Form 10-Q

Cash flows from financing activities

Warrant issued to related party shareholders	173,000
Payments of capital lease obligation	--
Net proceeds from exercise of stock options	--
Purchase of Treasury Stock	(22,000)

Net cash used in financing activities	151,000

Net decrease in cash and cash equivalents	(4,139,000)
Cash and cash equivalents - beginning of period	6,730,000

Cash and cash equivalents - end of period	\$2,591,000
	=====
Supplemental disclosure of cash flow information:	
Cash paid for interest	\$129,000
	=====

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

6

BLUEFLY, INC.
JUNE 30, 2008

NOTE 1 - BASIS OF PRESENTATION

The accompanying financial statements include the accounts of Bluefly, Inc. (the "Company"). The financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnote disclosures required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting mainly of normal recurring accruals) considered necessary for a fair statement have been included. The results of operations of any interim period are not necessarily indicative of the results of operations to be expected for the fiscal year due to seasonal and other factors. For further information, refer to the financial statements and accompanying footnotes included in the Company's Form 10-K for the year ended December 31, 2007.

During the second quarter of 2008, the Company revised its cash flow presentation of a warrant issued in the first quarter of 2008. The amount of \$173,000 was initially reported as an operating activity. For the six months ended June 30, 2008, the Condensed Statements of Cash Flows has been revised to reflect this transaction as a financing activity.

The Company has sustained net losses and negative cash flows from operations since the launch of Bluefly.com. The Company's ability to meet its obligations in the ordinary course of business is dependent on its ability to establish profitable operations, or find other sources to fund operations. The Company believes that its current funds, together with working capital, and its availability under its existing Credit Facility and the Commitment (as such terms are hereinafter defined), will be sufficient to enable it to meet its planned expenditures through at least the next 12 months.

NOTE 2 - THE COMPANY

Edgar Filing: BLUEFLY INC - Form 10-Q

The Company is a leading Internet retailer that sells over 350 brands of designer apparel, accessories and home products at discounts of up to 75% off of retail value. The Company's e-commerce Web site ("Bluefly.com" or "Web Site") was launched in September 1998.

NOTE 3 - REVERSE STOCK SPLIT

On March 13, 2008, the Company's Board of Directors approved a 1-for-10 reverse stock split of the Company's Common Stock. The record date for the reverse stock split was April 3, 2008, and the reverse stock split was effective as of 11:59 P.M. EST on the same date. Retroactive restatement has been given to all share numbers in this report, and accordingly, all amounts including per share amounts are shown on a post-split basis.

NOTE 4 - NASDAQ COMPLIANCE

From August 2007 to April 2008, the Company was not in compliance with the \$1.00 minimum per share requirement for continued listing as set forth in Nasdaq Marketplace Rule 4310(c)(4). Following the implementation of the reverse stock split described in Note 3, the Company's Common Stock closed at a price of \$1.00 or more for ten consecutive trading days, and regained compliance with such rule on April 17, 2008. In addition, on April 16, 2008, the Company received a letter from the Nasdaq Listing Qualifications Staff (the "Staff") stating that it had determined that the Company had failed to comply with the shareholder approval rules set forth in Nasdaq Marketplace Rule 4350(i)(1)(A) because certain warrants issued to affiliates of Soros Fund Management LLC ("Soros") and private funds associated with Maverick Capital, Ltd. ("Maverick"), each of whom has representation on the Company's Board of Directors, in connection with their debt financing commitment had originally been issued with an exercise price based on the twenty-day trailing average trading price of the Company's Common Stock, which was lower than the market value of the Company's Common Stock on the day immediately preceding the issuance of the warrants. The Staff advised the Company that the issuance of the warrants to Soros and Maverick at a price less than the market value would be treated as equity compensation and would require shareholder approval pursuant to Nasdaq Marketplace Rule 4350(i)(1)(A), unless the exercise price of the warrants was increased to market value. Thereafter, the Company, Soros and Maverick agreed to amend the terms of the warrants to increase the exercise price of the warrants to a price equal to the market value of the Company's Common Stock on the day immediately preceding the issuance of the warrants. As a result, the Staff determined that the Company had regained compliance with such rule by amending the warrants to increase the exercise price. Accordingly, the Company believes that it has now resolved all outstanding issues regarding Nasdaq listing requirements.

NOTE 5 - 2008 COMMITMENT FROM RELATED PARTY

In March 2008, the Company entered into an agreement (the "Commitment") with affiliates of Soros Fund Management LLC ("Soros") and private funds associated with Maverick Capital, Ltd. ("Maverick") pursuant to which they agreed to provide up to \$3 million of debt financing to the Company, on a standby basis, available until March 2009, provided that the commitment

7

BLUEFLY, INC.
JUNE 30, 2008

amount would be reduced by the gross proceeds of any equity financing consummated during the year. The Company drew down the entire \$3 million of debt in July 2008. The draw down is evidenced by subordinated convertible notes (the "Subordinated Notes") that have a term expiring three years from the date of

Edgar Filing: BLUEFLY INC - Form 10-Q

issuance and bear interest at the rate of 8% per annum, compounded annually. Interest is payable upon maturity or conversion. The Subordinated Notes are convertible, at the holder's option into (a) equity securities that the Company might issue in any subsequent round of financing at a price equal to the lowest price per share paid by any investor in such subsequent round of financing or (b) Common Stock at a price per share equal to \$3.65, which represented the 20-day trailing average stock price on the date of issuance of the Subordinated Note.

As a result of the issuance of the Notes, the conversion price of the Company's Series F Convertible Preferred Stock, automatically decreased from \$8.20 to \$3.65. In accordance with FASB Emerging Issue Task Force Issue No. 00-27, "Application of Issue No. 98-5 to Certain Convertible Instruments," this reduction in the conversion price of the Company's Series F Preferred Stock will result in the Company recording a beneficial conversion feature in the approximate amount of approximately \$700,000 as part of its third quarter financial results. This non-cash charge, which is analogous to a dividend, will result in an adjustment to the Company's computation of Loss Per Share.

In connection with the Commitment, the Company issued warrants to Soros and Maverick to purchase an aggregate of 52,497 shares of Common Stock at an exercise price equal to the trailing 20-day average stock price, or \$4.40. On April 8, 2008, the warrants were amended to increase the exercise price from \$4.40 per share to \$5.10 per share. The exercise price of \$5.10 per share equals the closing price of the Company's Common Stock on the day immediately preceding the issuance of the warrants. There was no accounting impact as a result of the modification.

The Company used the Black-Scholes option pricing method (assumption: volatility 79.6%, risk free rate 2.96%, one and a five year expected life and zero dividend yield) to calculate the value of the 52,497 warrants issued in connection with the Commitment. Using those assumptions, a value of approximately \$173,000 was assigned to the warrants. This amount was credited to additional paid in capital and is being accounted for as interest expense over the life of the commitment which is one year.

NOTE 6 - FINANCING AGREEMENT

In March 2008, the Company amended its credit facility (the credit facility as amended is hereafter referred to as the "Credit Facility") with Wells Fargo Retail Finance, LLC ("Wells Fargo") to (i) extend the term until July 26, 2011 from July 26, 2008; (ii) change the rate at which interest accrues on the average daily amount under the Credit Facility during the preceding month to a per annum rate equal to the prime rate plus 0.75% or LIBOR plus 3.25% on average excess availability less than \$3.0 million and prime rate plus 0.50% or LIBOR plus 3% on average excess availability greater than \$3.0 million; (iii) increase the monthly commitment fee on the unused portion of the Credit Facility to 0.50% from 0.35%; (iv) include a servicing fee of \$3,333 per month; (v) increase the early termination fee to 1% of the revolving credit ceiling, from 0.50% through maturity; and (vi) amend the standby and documentary letter of credit fees to 3.25% and 2.75%, respectively, on average excess availability less than \$3.0 million, and 3.00% and 2.50%, respectively, on average excess availability greater than \$3.0 million.

In addition, the amendment provides that no revolving credit loans shall be made unless the full amount available pursuant to the Commitment has been advanced to the Company and is outstanding. In connection with this amendment, the Company paid Wells Fargo a \$35,000 amendment fee. Under the terms of a Subordination and Intercreditor Agreement, dated as of March 26, 2008 (the "Subordination Agreement"), Soros and Maverick have the right to purchase all of the Company's obligations from Wells Fargo at any time if the Company is in default under the Credit Facility.

Edgar Filing: BLUEFLY INC - Form 10-Q

Under the terms of the Credit Facility, Wells Fargo provides the Company with a revolving credit facility and issues letters of credit in favor of suppliers or factors. The Credit Facility is secured by a lien on substantially all of the Company's assets. Availability under the Credit Facility is determined by a formula that takes into account a certain percentage of the amount of the Company's inventory and a certain percentage of the Company's accounts receivable. The maximum availability is currently \$7,500,000, but can be increased to \$12,500,000 at the Company's request, subject to certain conditions. As of June 30, 2008, total availability under the Credit Facility was approximately \$6,327,000, of which \$3,800,000 was committed, leaving approximately \$2,527,000 available for further borrowings.

For the three months and six months ended June 30, 2008, the Company incurred approximately \$81,000 and \$129,000 of fees, respectively, under the Credit Facility.

NOTE 7 - LOSS PER SHARE

8

BLUEFLY, INC.
JUNE 30, 2008

The Company has determined Loss Per Share in accordance with Statement of Financial Accounting Standards ("SFAS") No. 128, "Earnings Per Share." Basic loss per share excludes dilution and is computed by dividing loss available to common shareholders by the weighted average number of common shares outstanding for the period.

Due to the loss from continuing operations, (i) options and warrants to purchase shares of Common Stock, (ii) Preferred Stock convertible into shares of Common Stock, (iii) restricted stock awards that have not yet vested and (iv) deferred stock unit awards for shares that have not yet been delivered were not included in the computation of diluted loss per share:

Security -----	June 30, 2008 -----	Exercise Prices -----	June 30, 2007 -----	Exe ---
Options	368,353	\$4.10 - \$27.30	354,191	\$8.
Restricted Stock Awards/DSUs	856,536 (2)	--	1,080,068 (2)	
Warrants	113,574	\$5.10 - \$39.60	121,425	\$7
Preferred Stock	69,634 (1)	--	69,634 (1)	

(1) At June 30, 2008 and 2007, there were 571 shares of Series F Convertible Preferred Stock outstanding that are convertible into approximately 69,634 shares of Common Stock (excluding dividends).

(2) Includes Restricted Stock Awards and DSUs.

NOTE 8 - STOCK BASED COMPENSATION

The Company accounts for stock based compensation in accordance with the provisions of Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment" ("SFAS No. 123(R)"), which requires that the costs resulting from all share-based payment transactions be recognized in the financial statements at their fair values. The Company adopted SFAS No. 123(R) using the modified prospective application method under which the provisions of

Edgar Filing: BLUEFLY INC - Form 10-Q

SFAS No. 123(R) apply to new awards and to awards modified, repurchased, or cancelled after the adoption date. Additionally, compensation cost for the portion of the awards for which the requisite service has not been rendered that are outstanding as of the adoption date is recognized in the Statement of Operations over the remaining service period after the adoption date based on the award's original estimate of fair value. Total share-based compensation expense recorded in the Statement of Operations for the three months ended June 30, 2008 and 2007 was \$848,000 and \$1,506,000, and for the six months ended June 30, 2008 and 2007 was \$1,647,000 and \$3,227,000, respectively.

Stock Options The fair value of options granted is estimated on the date of grant using a Black-Scholes option pricing model. Expected volatilities are calculated based on the historical volatility of the Company's Common Stock. Management monitors share option exercise and employee termination patterns to estimate forfeiture rates within the valuation model. The expected holding period of options represents the period of time that options granted are expected to be outstanding. The risk-free interest rate for periods within the expected life of the option is based on the interest rate of U.S. Treasury notes in effect on the date of the grant.

The following table summarizes the Company's stock option activity:

	Number of shares	Weighted Average Price
Balance at January 1, 2008	342,879	
Options granted	35,000	
Options canceled	(9,526)	
Options exercised	--	
Balance at June 30, 2008	368,353	
Vested at December 31, 2007	287,112	
Vested at June 30, 2008	305,969	

9

BLUEFLY, INC.
JUNE 30, 2008

During the second quarter of 2008, 15,387 options vested. The total fair value of the options that vested during the quarter ended June 30, 2008 was approximately \$161,000. There were no stock options granted during the second quarter of 2008. At June 30, 2008, the aggregate intrinsic value of the fully vested options was \$0 and the weighted average remaining contractual life of the options was approximately 4 years. The Company has not capitalized any compensation cost, or modified any of its stock option grants during the first half of 2008. During the second quarter of 2008, no options were exercised and no cash was used to settle equity instruments granted under the Plans.

As of June 30, 2008, the total compensation cost related to non-vested stock option awards not yet recognized was \$225,000. Total compensation cost is expected to be recognized over one year on a weighted average basis.

Restricted Stock Awards and Deferred Stock Unit Awards

The following table is a summary of activity related to restricted stock awards and deferred stock unit awards for employees at June 30, 2008:

Edgar Filing: BLUEFLY INC - Form 10-Q

	Restricted Stock Awards	Deferre Unit
Balance at January 1, 2008	39,653	
Shares/Units Granted	8,625	
Shares/Units Forfeited	(750)	
Shares/Units Restriction Lapses	(38,528)	
Balance at June 30, 2008	9,000	
Weighted Average Grant Date Fair Value Per share	\$3.39	
Aggregate Grant Date Fair Value	\$30,510	\$3,
Vesting Service Period of Shares Granted	12 months	12-36
Number of shares/units vested at June 30, 2008	--	
Number of shares/units unvested at June 30, 2008	9,000	

For the quarter ended June 30, 2008 the Company recognized an expense of approximately \$689,000 in connection with these awards.

As of June 30, 2008 the total compensation cost related to non-vested restricted stock and deferred stock units not yet recognized was \$2,597,000 million. Total compensation cost is expected to be recognized over a one year period.

NOTE 9 - FAIR VALUE

Effective January 1, 2008, the Company implemented Statement of Financial Accounting Standard No. 157, Fair Value Measurement, ("SFAS 157"), which defines fair value, establishes a framework for measuring fair value and expands disclosure about fair value measurements. The fair value hierarchy for disclosure of fair value measurements under SFAS 157 is as follows:

Level 1 - Quoted prices in active markets for identical assets or liabilities

Level 2 - Quoted prices for similar assets and liabilities in active markets or inputs that are observable

Level 3 - Inputs that are unobservable (for example cash flow modeling inputs based on assumptions)

The adoption of FAS 157 did not have an impact on our financial position or results of operations.

In February 2008, the FASB issued FASB Staff Position 157-2 ("FSP 175-2"), which delayed the implementation of FAS 157 until January 1, 2009, for non-financial assets and liabilities that are not required to be measured at fair value on a recurring basis. Pursuant to FSP 157-2, the Company did not adopt FAS 157 for non-financial assets and liabilities. We are currently assessing the impact of FAS 157 on our non-financial assets and liabilities.

10

BLUEFLY, INC.
JUNE 30, 2008

The Company did not have any other significant financial assets or liabilities not currently valued at fair value.

NOTE 10 - RECENT ACCOUNTING PRONOUNCEMENTS

Edgar Filing: BLUEFLY INC - Form 10-Q

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities," ("SFAS No. 161"). SFAS No. 161 amends and expands the disclosure requirements of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 161 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of gains and losses on derivative instruments and disclosures about credit-risk-related contingent features in derivative agreements. This statement is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The adoption of SFAS No. 161 will not affect our financial condition and results of operations, but may require additional disclosures if we enter into derivative and hedging activities.

In April 2008, the FASB issued EITF 07-05, "Determining whether an Instrument (or Embedded Feature) Is Indexed to an Entity's Own Stock", ("EITF 07-05"). EITF 07-05 provides guidance on determining what types of instruments or embedded features in an instrument held by a reporting entity can be considered indexed to its own stock for the purpose of evaluating the first criteria of the scope exception in paragraph 11(a) of FAS 133. EITF 07-05 is effective for financial statements issued for fiscal years beginning after December 15, 2008 and early application is not permitted. Management is evaluating what effect EITF 07-05 will have on the Company's financial position and operating results.

In May 2008, the FASB issued Staff Position No. APB 14-1 "Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)" ("FSP APB 14-1") that requires the liability and equity components of convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement) to be separately accounted for in a manner that reflects the issuer's nonconvertible debt borrowing rate. FSP APB 14-1 requires that the value assigned to the debt component would be the estimated fair value of a similar nonconvertible debt. The resulting debt discount would be amortized over the period during which the debt is expected to be outstanding (i.e., through the first optional redemption date) as additional non-cash interest expense. FSP APB 14-1 will become effective beginning in our first quarter of 2009 and is required to be applied retrospectively to all presented periods, as applicable. The Company is evaluating the effects of adopting FSP APB 14-1.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

Bluefly, Inc. is a leading Internet retailer that sells over 350 brands of designer apparel, accessories and home furnishings at discounts of up to 75% off of retail value. We launched our Web site in September 1998.

We believe that there is an opportunity to accelerate the growth of our business while continuing to provide our customers with the great values that they have become accustomed to. In an effort to take advantage of this opportunity, we began a national advertising campaign that featured both print and television. Over the past two and a half years, we have increased awareness by targeting general advertising efforts to a more fashion focused consumer. In 2007, we further refined our marketing strategy by aligning ourselves with entertainment properties, such as BravoTV.com and Project Runway.

Our net sales increased by approximately 8.0% to \$23,334,000 for the three months ended June 30, 2008 from \$21,608,000 for the three months ended June 30, 2007. Our gross margin remained relatively unchanged at 39.0% for the three months ended June 30, 2008 from 39.2% for the three months ended June 30, 2007. Our gross profit increased by 7.5% to \$9,098,000 for the three months ended June 30, 2008 from \$8,463,000 for the three months ended June 30, 2007. Our operating

Edgar Filing: BLUEFLY INC - Form 10-Q

loss decreased to \$1,941,000 for the three months ended June 30, 2008 from \$2,249,000 for the three months ended June 30, 2007. This decrease was primarily a result of an increase in net sales compared to the prior year as well as decreases in selling and fulfillment expenses and was partially offset by an increase in total marketing and general and administrative expenses. Marketing expenses (excluding staff related costs) increased to \$2,664,000 for the second quarter of 2008 from \$2,506,000 for the second quarter 2007, primarily as a result of growth of online marketing programs. Sales attributable to online marketing programs in the period increased by 6.6%. Expenditures for offline programs decreased 3.4% for the period and spending for online programs increased 8.2%. The company believes that online marketing programs are more efficient and intends to shift more of its spend toward online marketing programs from offline programs.

11

BLUEFLY, INC.
JUNE 30, 2008

Our reserve for returns and credit card chargebacks decreased to 40.0% of gross sales for the second quarter of 2008 compared to 42.1% for the second quarter of 2007. The decrease was primarily caused by a decrease in our return rate which was, in turn, caused in part, by a shift in our merchandise mix.

A portion of our inventory includes merchandise that we either purchased with the intention of holding for the appropriate season or were unable to sell through in its entirety in a prior season and have determined to hold for the next selling season, subject (in some cases) to appropriate mark-downs. In recent years, we have increased the amount of inventory purchased on a pack and hold basis in order to take advantage of opportunities in the market.

At June 30, 2008, we had an accumulated deficit of \$136,800,000. The net losses and accumulated deficit resulted primarily from the costs associated with developing and marketing our Web site and building our infrastructure, as well as non-cash beneficial conversion charges resulting from decreases in the conversion price of our Preferred Stock and the payment of non-cash dividends to holders of Preferred Stock. In order to expand our business, we intend to invest in sales, marketing, merchandising, operations, information systems, site development and additional personnel to support these activities. Therefore, we may continue to incur substantial operating losses. Although we have experienced revenue growth in recent years, this growth may not be sustainable and therefore should not be considered indicative of future performance.

Results Of Operations

For The Six Months Ended June 30, 2008 Compared To The Six Months Ended June 30, 2007.

The following table sets forth our statement of operations data for the six months ended June 30. All data is in thousands except as indicated below:

	2008 ----	As a % of Net Sales	2007 ----	As a % of Net Sales
Net sales	\$48,579	100.0%	\$43,716	100.0%
Cost of sales	30,545	62.9%	26,879	61.5%
	-----		-----	

Edgar Filing: BLUEFLY INC - Form 10-Q

Gross profit	18,034	37.1%	16,837	38.5%
Selling and fulfillment expenses	9,592	19.7%	8,945	20.4%
Marketing expenses	6,448	13.3%	6,323	14.5%
General and administrative expenses	6,837	14.1%	7,040	16.1%
	-----		-----	
Total operating expenses	22,877	47.1%	22,308	51.0%
Operating loss	(4,843)	(10.0)%	(5,471)	(12.5)%
Interest (expense) and income	(131)	(0.2)%	226	0.5%
	-----		-----	
Net loss	(4,974)	(10.2)%	(5,245)	(12.0)%

We also measure and evaluate ourselves against certain other key operational metrics. The following table sets forth our actual results based on these other metrics for the six months ended June 30:

	2008	2007
	----	----
Average Order Size (including shipping & handling)	\$279.04	\$276.00
New Customers Added during the Period*	102,529	94,000

* Based on unique email addresses

In addition to the financial statement items and metrics listed above, we also report gross sales, which is a non-GAAP financial measure. We define gross sales as the total dollar amount of orders received by customers (including shipping and handling) net of customer credits, but before any reserves are taken for returns or bad debt. We believe that the presentation of gross sales

12

BLUEFLY, INC.
JUNE 30, 2008

is useful to investors because (a) it provides an alternative measure of the total demand for the products sold by the Company and (b) it provides a basis upon which to measure the percentage of total demand that is reserved for both returns and bad debt. Management uses the gross sales measure for these same reasons.

Net sales: Gross sales for the six months ended June 30, 2008 increased by approximately 10.0% to \$81,079,000 from \$73,694,000 for the six months ended June 30, 2007. For the six months ended June 30, 2008, we recorded a provision for returns and credit card chargebacks and other discounts of \$32,500,000, or approximately 40.1% of gross sales. For the six months ended June 30, 2007, the provision for returns and credit card chargebacks and other discounts was \$29,978,000, or approximately 41.0% of gross sales. The decrease in this provision as a percentage of gross sales resulted from a slight decrease in the return rate. The decrease was primarily caused by a shift in our merchandise mix.

After the necessary provisions for returns, credit card chargebacks and adjustments for sales taxes, our net sales for the six months ended June 30, 2008 were \$48,579,000. This represents an increase of approximately 11% compared

Edgar Filing: BLUEFLY INC - Form 10-Q

to the six months ended June 30, 2007, in which net sales totaled \$43,716,000. The growth in net sales resulted primarily from an increase in the number of new customers acquired (over 8% higher compared to the first six months of 2007). For the six months ended June 30, 2008, revenue from shipping and handling (which is included in net sales) increased approximately 16.8% to \$2,794,000 from \$2,391,000 for the six months ended June 30, 2007. Shipping and handling revenue increased at a greater percentage than revenue as a whole as a result of an increased number of customers selecting express and international shipping.

Cost of sales: Cost of sales consists of the cost of product sold to customers, in-bound and out-bound shipping costs, inventory reserves, commissions and packing materials. Cost of sales for the six months ended June 30, 2008 totaled \$30,545,000, resulting in gross margin of approximately 37.1%. Cost of sales for the six months ended June 30, 2007 totaled \$26,879,000, resulting in gross margin of 38.5%. The gross margin was negatively effected, during the first quarter, by a decrease in the overall product margin, as we were more promotional during the first two months of the quarter compared to 2007, in order to liquidate some older inventory. Gross profit increased by approximately 7.1%, to \$18,034,000 for the six months ended June 30, 2008 compared to \$16,837,000 for the six months ended June 30, 2007. The growth in gross profit was primarily the result of growth in sales and was offset slightly by lower product margin percent.

Marketing expenses: Marketing expenses increased by 2% to \$6,448,000 for the six months ended June 30, 2008 from \$6,323,000 for the six months ended June 30, 2007.

Marketing expenses include expenses related to paid search, online and print advertising, television, fees to marketing affiliates, direct mail campaigns as well as staff related costs. As a percentage of net sales, our marketing expenses decreased to 13.3% for the six months ended June 30, 2008 from 14.5% for the six months ended June 30, 2007. Total expenses related to the national print and television advertising campaign for the six months ended June 30, 2008 totaled \$2.3 million compared to \$2.8 million for the six months ended June 30, 2007. In addition, expenses associated with direct mail campaigns and billboards decreased by \$61,000 and \$73,000, respectively. These decreases were offset by planned increases to online marketing programs with high return on investment, which resulted in the following increases: \$375,000 related to paid search, \$182,000 related to comparison engines, \$132,000 related to banner ads and other online advertisements, \$57,000 paid to consultants and \$71,000 in affiliate expenses.

Selling and fulfillment expenses: Selling and fulfillment expenses increased by 7.2% in the first six months of 2008 compared to the first six months of 2007. Selling and fulfillment expenses were comprised of the following:

	Six Months Ended June 30, 2008	As a % of Net Sales	Six Months Ended June 30, 2007	As a % of Net Sales	Percent increa
	-----	-----	-----	-----	-----
Operating	\$5,401,000	11.1%	4,732,000	10.8%	
Technology	2,494,000	5.1%	2,399,000	5.5%	
E-Commerce	1,697,000	3.5%	1,814,000	4.2%	
	-----	-----	-----	-----	
	\$9,592,000	19.7%	\$8,945,000	20.5%	

As a percentage of net sales, our selling and fulfillment expenses decreased to 19.7% for the six months ended June 30, 2008 from 20.5% for the six months ended June 30, 2007.

Edgar Filing: BLUEFLY INC - Form 10-Q

13

BLUEFLY, INC.
JUNE 30, 2008

Operating expenses include all costs related to inventory management, fulfillment, customer service, and credit card processing. Operating expenses increased in the first six months of 2008 by approximately 14.1% compared to the first six months of 2007 as a result of variable costs associated with the increased sales volume (e.g., picking and packing orders and processing returns) and price per order as well as an increase in customer service and salary related expenses.

Technology expenses consist primarily of staff related costs, amortization of capitalized costs and Web site hosting. For the six months ended June 30, 2008, technology expenses increased by approximately 4.0% compared to the six months ended June 30, 2007. This increase resulted from an increase in software support, depreciation and web hosting expenses, and was slightly offset by a decrease in salary related expenses. Consulting expenses incurred in the second quarter 2008 were related to the development of our new Web site and capitalized accordingly. For the six months ended June 30, 2008, approximately \$1,141,000 of expenses was capitalized in connection with the development of our new Web site. As of June 30, 2008, approximately \$4,774,000 has been capitalized in connection with the project.

E-Commerce expenses include expenses related to our photo studio, image processing, and Web site design. For the six months ended June 30, 2008, e-commerce expenses decreased by approximately 6.4% as compared to the six months ended June 30, 2007, primarily due to a decrease in expenses associated with photo shoots, supplies and research tools, and partially offset by an increase in salary related expenses.

General and administrative expenses: General and administrative expenses include merchandising, finance and administrative salaries and related expenses, insurance costs, accounting and legal fees, depreciation and other office related expenses. General and administrative expenses for the six months ended June 30, 2008 decreased by approximately 2.9% to \$6,837,000 as compared to \$7,040,000 for the six months ended June 30, 2007. The decrease in general and administrative expenses was primarily the result of a decrease in equity based compensation related to equity awards of \$1,363,000. These amounts were offset by increased salary related expenses of \$899,000, which includes \$280,000 of severance payable to our former Chief Financial Officer, as well as increased consulting and professional fees of \$163,000.

As a percentage of net sales, general and administrative expenses for the first half of 2008 decreased to approximately 14.1% from 16.1% for the first half of 2007.

Loss from operations: Operating loss decreased in the first six months of 2008 to \$4,843,000 from \$5,471,000 in the first six months of 2007.

Interest income: Other income for the six months ended June 30, 2008 decreased to \$49,000 from \$364,000 for the six months ended June 30, 2007. These amounts related primarily to interest income earned on our cash balances.

Interest expense: Interest expense for the six months ended June 30, 2008 totaled \$180,000, compared to \$138,000 for the six months ended June 30, 2007. Interest expense consists of fees paid in connection with our Credit Facility as well as amortization of warrants issued to a related party.

Edgar Filing: BLUEFLY INC - Form 10-Q

For The Three Months Ended June 30, 2008 Compared To The Three Months Ended June 30, 2007.

The following table sets forth our statement of operations data for the three months ended June 30. All data is in thousands except as indicated below:

	2008	-----	As a % of Net Sales	2007	-----	As a % of Net Sales
Net sales	\$23,334		100.0%	\$21,608		100.0%
Cost of sales	14,236		61.0%	13,145		60.8%
	-----			-----		
Gross profit	9,098		39.0%	8,463		39.2%
Selling and fulfillment expenses	4,523		19.4%	4,546		21.0%
Marketing expenses	2,926		12.5%	2,712		12.6%
General and administrative expenses	3,590		15.4%	3,454		16.0%
	-----			-----		

14

BLUEFLY, INC.
JUNE 30, 2008

Total operating expenses	11,039	47.3%	10,712	49.6%
Operating loss	(1,941)	(8.3)%	(2,249)	(10.4)%
Interest (expense) and other income	(95)	(0.4)%	107	0.5%
	-----		-----	
Net loss	(2,036)	(8.7)%	(2,142)	(9.9)%

The following table sets forth our actual results based on the other key operational metrics discussed above for the three months ended June 30, as indicated below:

	2008	-----	2007	-----	
Average Order Size (including shipping & handling)	\$285.14		\$284.01		\$
New Customers Added during the Period*	45,674		45,102		

* Based on unique email addresses

Net sales: Gross sales for the three months ended June 30, 2008 increased by approximately 4.2% to \$38,892,000 from \$37,327,000 for the three months ended June 30, 2007. For the three months ended June 30, 2008, we recorded a provision for returns and credit card chargebacks and other discounts of \$15,558,000, or approximately 40% of gross sales. For the three months ended June 30, 2007, the provision for returns and credit card chargebacks and other discounts was

Edgar Filing: BLUEFLY INC - Form 10-Q

\$15,719,000, or approximately 42.1% of gross sales. The decrease in this provision as a percentage of gross sales resulted from a decrease in the return rate. The decrease was primarily caused by a shift in our merchandise mix.

After the necessary provisions for returns, credit card chargebacks and adjustments for sales taxes, our net sales for the three months ended June 30, 2008 were \$23,334,000. This represents an increase of approximately 8.0% compared to the three months ended June 30, 2007, in which net sales totaled \$21,608,000. The growth in net sales resulted primarily from an increase in the number of new customers acquired (over 1% higher compared to the first three months of 2007) as well as a decrease in the return rate. For the three months ended June 30, 2008, revenue from shipping and handling (which is included in net sales) increased approximately 12.9% to \$1,344,000 from \$1,190,000 for the three months ended June 30, 2007. Shipping and handling revenue increased at a greater percentage than revenue as a whole as a result of an increased number of customers selecting express and international shipping.

Cost of sales: Cost of sales for the three months ended June 30, 2008 totaled \$14,236,000, resulting in gross margin of approximately 39.0%. Cost of sales for the three months ended June 30, 2007 totaled \$13,145,000, resulting in gross margin of 39.2%. Gross profit increased by approximately 7.5%, to \$9,098,000 for the three months ended June 30, 2008 compared to \$8,463,000 for the three months ended June 30, 2007.

Marketing expenses: Marketing expenses increased by 7.9% to \$2,926,000 for the three months ended June 30, 2008 from \$2,712,000 for the three months ended June 30, 2007.

As a percentage of net sales, our marketing expenses remained relatively unchanged at 12.5% for the three months ended June 30, 2008 compared to 12.6% for the three months ended June 30, 2007. Total expenses related to the national print and television advertising campaign for the three months ended June 30, 2008 were \$935,000 compared to \$929,000 for the three months ended June 30, 2007. In addition, expenses related to online marketing programs increased as the Company believes that these are efficient. Paid search, comparison engines and banner ads increased by \$154,000, \$85,000 and \$57,000, respectively. These increases were partially offset by the following decreases, \$44,000 of direct mail campaigns, \$36,000 related to billboard advertising and \$14,000 paid to consultants.

Selling and fulfillment expenses: Selling and fulfillment expenses decreased by 0.5% in the first three months of 2008 compared to the first three months of 2007. Selling and fulfillment expenses were comprised of the following:

15

BLUEFLY, INC.
JUNE 30, 2008

	Three Months Ended June 30, 2008 -----	As a % of Net Sales -----	Three Months Ended June 30, 2007 -----	As a % of Net Sales -----
Operating	\$2,457,000	10.5%	2,467,000	11.4%
Technology	1,212,000	5.2%	1,231,000	5.7%
E-Commerce	854,000	3.7%	848,000	3.9%
	-----	-----	-----	-----

Edgar Filing: BLUEFLY INC - Form 10-Q

\$4,523,000

19.4%

\$ 4,546,000

21.0%

As a percentage of net sales, our selling and fulfillment expenses decreased to 19.4% for the three months ended June 30, 2008 from 21% for the three months ended June 30, 2007.

Operating expenses remained relatively unchanged for the three months ended June 30, 2008 compared to June 30, 2007. Increased variable costs associated with the increased sales volume (e.g., picking and packing orders and processing returns) and price per order was offset by a decrease in customer service and salary related expenses.

For the three months ended June 30, 2008, technology expenses decreased by approximately 1.5% compared to the three months ended June 30, 2007. This decrease resulted from a decrease in consulting and salary related expense offset by an increase in software support, depreciation and web hosting expenses. Consulting expenses incurred in the second quarter of 2008 were related to the development of our new Web site and capitalized accordingly. For the three months ended June 30, 2008, approximately \$730,000 of expenses was capitalized in connection with the development of our new Web site.

For the three months ended June 30, 2008, e-commerce expenses remained relatively unchanged as compared to the three months ended June 30, 2007, primarily due to an increase in salary related expenses offset by a decrease in expenses associated with consulting, photo shoots, supplies and research tools.

General and administrative expenses: General and administrative expenses for the three months ended June 30, 2008 increased by approximately 3.9% to \$3,590,000 as compared to \$3,454,000 for the three months ended June 30, 2007. The increase in general and administrative expenses was primarily the result of an increase in salaries and related expenses of \$605,000 which includes \$280,000 of severance payable to our former Chief Financial Officer. In addition, consulting and professional fees increased by \$109,000. These amounts were offset by a decrease in equity based compensation of \$588,000.

As a percentage of net sales, general and administrative expenses for the three months ended June 30, 2008 decreased to approximately 15% from 16.0% for the three months ended June 30, 2007.

Loss from operations: Operating loss decreased in the first three months of 2008 to \$1,941,000 from \$2,249,000 in the first three months of 2007.

Interest income: Other income for the three months ended June 30, 2008 decreased to \$13,000 from \$169,000 for the three months ended June 30, 2007. These amounts related primarily to interest income earned on our cash balances.

Interest expense: Interest expense for the three months ended June 30, 2008 totaled \$108,000, compared to \$62,000 for the three months ended June 30, 2007. Interest expense consists of fees paid in connection with our Credit Facility as well as amortization of warrants issued to a related party.

Liquidity And Capital Resources

General

At June 30, 2008, we had approximately \$2.6 million in cash and cash equivalents. Working capital at June 30, 2008 and 2007 was \$16.9 million and \$30.6 million, respectively. Working capital at December 31, 2007 was \$21.0 million. In addition, as of June 30, 2008, we had approximately \$3.8 million committed under the Credit Facility, leaving approximately \$2.5 million of availability and \$3.0 million available under the Commitment.

Edgar Filing: BLUEFLY INC - Form 10-Q

We fund our operations through cash on hand, operating cash flow and the proceeds of any equity or debt financing. Operating cash flow is affected by revenue and gross margin levels, as well as return rates, and any deterioration in our performance with respect to these financial measures would have a negative impact on our liquidity. Total availability under the Credit Facility is

16

BLUEFLY, INC.
JUNE 30, 2008

based primarily upon our inventory levels. In addition, both availability under the Credit Facility and our operating cash flows are affected by the payment terms that we receive from suppliers and service providers, and the extent to which suppliers require us to request Wells Fargo to provide credit support under the Credit Facility. In some instances, new vendors may require prepayments. We may make prepayments in order to open up these new relationships, or to gain access to inventory that would not otherwise be available to us. In addition, we sometimes make prepayments in connection with our advertising campaign, as in some circumstances we need to pay in advance of production. As of June 30, 2008, we had approximately \$106,000 of prepaid inventory and approximately \$610,000 of prepaid marketing on our balance sheet compared to \$569,000 and \$696,000 in the second quarter of 2007.

Standby Financing Commitment

In March 2008, Soros and Maverick agreed to provide up to \$3 million of debt financing to us, on a standby basis, available until March 2009, provided that the commitment amount would be reduced by the gross proceeds of any equity financing consummated during the year. Subsequent to quarter end, the Company drew down on the full amount of the Commitment. The draw down is evidenced by the Subordinated Notes. The Subordinated Notes have a term expiring three years from the date of issuance and bear interest at the rate of 8% per annum, compounded annually. Interest is payable upon maturity or conversion. The Subordinated Notes are convertible, at the holder's option into (a) equity securities that the Company might issue in any subsequent round of financing at a price equal to the lowest price per share paid by any investor in such subsequent round of financing or (b) Common Stock at a price per share equal to \$3.65, which represents the 20-day trailing average stock price on the date of issuance of the Subordinated Note.

Credit Facility

Pursuant to the Credit Facility, Wells Fargo provides us with a revolving loan and issues letters of credit in favor of suppliers or factors. The Credit Facility is secured by a lien on all of our assets. Availability under the Credit Facility is determined by a formula that takes into account a certain percentage of our inventory and a certain percentage of our accounts receivable. The maximum availability is currently \$7,500,000, but can be increased to \$12,500,000 at our request, subject to certain conditions. As of June 30, 2008, total availability under the Credit Facility was approximately \$6,327,000 of which \$3,800,000 was committed, leaving approximately \$2,527,000 available for further borrowings.

Interest accrues monthly on the average daily amount outstanding under the Credit Facility during the preceding month at a per annum rate equal to the prime rate plus 0.75% or LIBOR plus 3.25% on average excess availability less than \$3.0 million and prime rate plus 0.50% or LIBOR plus 3% on average excess availability greater than \$3.0 million. We also pay a monthly commitment fee on

Edgar Filing: BLUEFLY INC - Form 10-Q

the unused portion of the facility (i.e., \$7,500,000 less the amount of loans outstanding) equal to 0.50% and a servicing fee of \$3,333 per month. We also pay Wells Fargo certain fees to open letters of credit and guarantees in an amount equal to a certain specified percentage of the face amount of the letter of credit for each thirty (30) days of such letter of credit, or a portion thereof, remains open. No revolving credit loans may be made under the Credit Facility unless the full amount available pursuant to the Commitment has been advanced to the Company and is outstanding.

Under the terms of the Subordination Agreement, Soros and Maverick have the right to purchase all of our obligations from Wells Fargo at any time if we are then in default under the Credit Facility.

We believe that our current funds, together with operating cash flow, and availability under our existing Credit Facility will be sufficient to enable us to meet our planned expenditures through the next 12 months. However, in order to accelerate the growth of our business, we intend to seek to raise additional equity capital. However there can be no assurance that we will be able to identify a source for such financing, or that such financing will be on terms acceptable to the Company.

Commitments and Long Term Obligations

As of June 30, 2008, we had the following commitments and long term obligations:

	Total	Less than 1 year	1-3 years	3-5 years	More than years
Marketing and Advertising	\$2,986,000	2,986,000	--	--	--
Purchase Orders	17,494,000	17,446,000	48,000	--	--

17

BLUEFLY, INC.
JUNE 30, 2008

Operating Leases	1,962,000	712,000	1,250,000	--	--
Employment Contracts	5,054,000	1,605,000	3,406,000	43,000	--
	-----	-----	-----	-----	-----
Grand total	\$27,496,000	22,749,000	4,704,000	43,000	--

We believe that in order to grow the business, we will need to make additional marketing and advertising commitments in the future. In addition, we expect to hire and train additional employees for the operations and development of Bluefly.com. However, our marketing budget and our ability to hire such employees is subject to a number of factors, including our results of operations.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We have assessed our vulnerability to certain market risks, including interest rate risk associated with financial instruments included in cash and cash equivalents. Due to the short-term nature of these instruments, we have

Edgar Filing: BLUEFLY INC - Form 10-Q

determined that the risks associated with interest rate fluctuations related to these financial instruments do not pose a material risk to us.

Item 4 T. Controls and Procedures.

As of the end of the period covered by this Form 10-Q (the "Evaluation Date"), we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer along with our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)). Based upon that evaluation, our Chief Executive Officer along with our Chief Financial Officer concluded that, as of the Evaluation Date, our disclosure controls and procedures were effective in ensuring that information required to be disclosed by us in the reports that we file or submit under the Exchange Act were recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms and are effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our principal executive and principal financial officers, to allow timely decisions regarding required disclosure. There have been no changes in our internal control over financial reporting that occurred during the Company's most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Special Note Regarding Forward Looking Statements

This report may include statements that constitute "forward-looking" statements, usually containing the words "believe", "project", "expect", or similar expressions. These statements are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements inherently involve risks and uncertainties that could cause actual results to differ materially from the forward-looking statements. The risks and uncertainties are detailed from time to time in reports filed by us with the Securities and Exchange Commission, including Forms 8-A, 8-K, 10-Q, and 10-K. These risks and uncertainties include, but are not limited to, the following: our history of losses and anticipated future losses; our ability to raise additional capital to support the growth of our business; the risk associated with the Company's transition to a new technology platform; the success of our advertising campaign; risks associated with Soros, Maverick and private funds associated with and Prentice Capital Management, LP each owning a significant portion of our stock; the potential failure to forecast revenues and/or to make adjustments to our operating plans necessary as a result of any failure to forecast accurately; our ability to raise additional capital; issues related to our transition to a new third party fulfillment facility; unexpected changes in fashion trends; cyclical variations in the apparel and e-commerce markets; the risk of default by us under the Credit Facility and the consequences that might arise from us having granted a lien on substantially all of our assets under that agreement; risks of litigation for sale of unauthentic or damaged goods and litigation risks related to sales in foreign countries; the dependence on third parties and certain relationships for certain services, including our dependence on UPS, DHL and USPS (and the risks of a mail slowdown due to terrorist activity) and our dependence on our third-party web hosting, fulfillment and customer service centers; online commerce security risks; risks related to brand owners' efforts to limit our ability to purchase products indirectly; management of potential growth; the competitive nature of our business and the potential for competitors with greater resources to enter the business; the availability of merchandise; the need to further establish brand name recognition; risks associated with our ability to handle increased traffic and/or continued improvements to our Web site; rising return rates; dependence upon executive personnel; the successful hiring and retaining of new personnel; risks associated with expanding our operations; risks associated with potential

Edgar Filing: BLUEFLY INC - Form 10-Q

infringement of other's intellectual property; the potential inability to protect our intellectual property; government regulation and legal uncertainties; and uncertainties relating to the imposition of sales tax on Internet sales.

Part II - OTHER INFORMATION

18

BLUEFLY, INC.
JUNE 30, 2008

Item 1. Legal Proceedings

We currently and from time to time are involved in litigation incidental to the conduct of our business. However, we are not party to any lawsuit or proceeding which in the opinion of management is likely to have a material adverse effect on us.

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

On May 29, 2008, we held our annual meeting of stockholders. At the meeting, our stockholders voted for ten directors, electing David Wassong, Melissa Payner-Gregor, Barry Erdos, Riad Abrahams, Ann Jackson, Christopher G. McCann, Martin Miller, Neal Moszkowski, Anthony Plesner and Lawrence Zigerelli as members of our board of directors. In addition, our stockholders voted in favor of a proposals to approve the conversion features of certain promissory notes (the "Note Conversion Provisions"). The results of the voting were as follows:

Proposal -----	Votes For -----	Votes Withheld -----
Election of David Wassong	12,306,521	293,914
Election of Melissa Payner-Gregor	12,303,976	296,459
Election of Barry Erdos	12,308,683	291,752
Election of Riad Abrahams	12,308,223	292,212
Election of Christopher G. McCann	12,308,918	291,517
Election of Ann Jackson	10,903,116	1,697,319
Election of Martin Miller	12,308,804	291,631
Election of Neal Moszkowski	12,308,226	292,209
Election of Anthony Plesner	12,306,477	293,958
Election of Lawrence Zigerelli*	12,308,769	291,666

Votes For -----	Votes Against -----
--------------------	------------------------

Edgar Filing: BLUEFLY INC - Form 10-Q

Approval of conversion provisions
of certain convertible promissory notes 11,353,473 179,657

*subsequent to quarter end Mr. Zigerelli resigned from the Board

Item 6. Exhibits

The following is a list of exhibits filed as part of this Report:

Exhibit Number	Description
10.1	Fifth Amendment, dated as of June 30, 2008, to Loan and Security Agreement July 25, 2006, by and between Bluefly, Inc. and Wells Fargo Retail Finance
31.1	Certification Pursuant to Rule 13a-14(a)/15d-14(a)
31.2	Certification Pursuant to Rule 13a-14(a)/15d-14(a)

19

BLUEFLY, INC.
JUNE 30, 2008

32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Sarbanes-Oxley Act of 2002
32.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Sarbanes-Oxley Act of 2002

20

SIGNATURES

In accordance with the requirements of the Securities Exchange Act of 1934, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

BLUEFLY, INC.

By: /s/ Melissa Payner-Gregor

Melissa Payner-Gregor
Chief Executive Officer

By: /s/ Kara B. Jenny

Kara B. Jenny
Chief Financial Officer

August 12, 2008

