

JOE'S JEANS INC.
Form 10-Q
October 11, 2011
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended August 31, 2011

OR

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

For the transition period from _____ to _____

Commission File Number: 0-18926

JOE S JEANS INC.

(Exact name of registrant as specified in its charter)

Edgar Filing: JOE'S JEANS INC. - Form 10-Q

Delaware

(State or other jurisdiction of incorporation or organization)

11-2928178

(I.R.S. Employer Identification No.)

2340 South Eastern Avenue, Commerce, California

(Address of principal executive offices)

90040

(Zip Code)

(323) 837-3700

(Registrant's telephone number, including area code)

NO CHANGE

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or such shorter period that the registrant was required to submit and post such files). 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 definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

The number of shares of the registrant's common stock outstanding as of October 11, 2011 was 64,887,631.

Table of Contents

JOE S JEANS INC.

QUARTERLY REPORT ON FORM 10-Q

	Page
<u>PART I. FINANCIAL INFORMATION</u>	1
<u>Item 1. Financial Statements</u>	1
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	17
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	30
<u>Item 4. Controls and Procedures</u>	30
<u>PART II. OTHER INFORMATION</u>	31
<u>Item 1. Legal Proceedings</u>	31
<u>Item 1A. Risk Factors</u>	31
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	31
<u>Item 3. Defaults upon Senior Securities</u>	31
<u>Item 4. (Removed and Reserved)</u>	31
<u>Item 5. Other Information</u>	31
<u>Item 6. Exhibits</u>	32
<u>SIGNATURES</u>	33

Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements.****JOE S JEANS INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS**

(in thousands, except per share data)

	August 31, 2011 (unaudited)	November 30, 2010
ASSETS		
Current assets		
Cash and cash equivalents	\$ 11,641	\$ 6,410
Accounts receivable, net	1,846	2,374
Inventories, net	24,891	30,245
Due from related parties		38
Deferred income taxes, net	3,225	3,225
Prepaid expenses and other current assets	1,559	1,092
Total current assets	43,162	43,384
Property and equipment, net	5,515	5,721
Goodwill	3,836	3,836
Intangible assets	24,000	24,000
Deferred income taxes, net	4,179	4,179
Other assets	547	349
Total assets	\$ 81,239	\$ 81,469
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities		
Accounts payable and accrued expenses	\$ 10,420	\$ 10,373
Due to factor	4,561	4,972
Due to related parties	438	333
Total current liabilities	15,419	15,678
Deferred rent	1,223	918
Total liabilities	16,642	16,596
Commitments and contingencies		
Stockholders equity		
Common stock, \$0.10 par value: 100,000 shares authorized, 65,159 shares issued and 64,887 outstanding (2011) and 64,131 shares issued and 63,859 outstanding (2010)	6,518	6,415
Additional paid-in capital	105,082	104,364
Accumulated deficit	(43,946)	(42,849)

Edgar Filing: JOE'S JEANS INC. - Form 10-Q

Treasury stock, 272 shares		(3,057)		(3,057)
Total stockholders' equity		64,597		64,873
Total liabilities and stockholders' equity	\$	81,239	\$	81,469

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

Table of Contents**JOE S JEANS INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF INCOME****(in thousands, except per share data)**

	Three months ended		Nine months ended	
	August 31, 2011	August 31, 2010	August 31, 2011	August 31, 2010
	(unaudited)		(unaudited)	
Net sales	\$ 24,151	\$ 25,534	\$ 70,032	\$ 74,611
Cost of goods sold	14,407	13,732	38,382	39,942
Gross profit	9,744	11,802	31,650	34,669
Operating expenses				
Selling, general and administrative	10,919	10,070	30,053	29,986
Depreciation and amortization	323	223	887	604
Retail stores impairment	1,144		1,144	
	12,386	10,293	32,084	30,590
Operating (loss) income	(2,642)	1,509	(434)	4,079
Interest expense	111	113	365	329
(Loss) income before provision for taxes	(2,753)	1,396	(799)	3,750
Income tax (benefit) expense	(715)	838	298	1,966
Net (loss) income	\$ (2,038)	\$ 558	\$ (1,097)	\$ 1,784
(Loss) earnings per common share - basic				
	\$ (0.03)	\$ 0.01	\$ (0.02)	\$ 0.03
(Loss) earnings per common share - diluted				
	\$ (0.03)	\$ 0.01	\$ (0.02)	\$ 0.03
Weighted average shares outstanding				
Basic	64,128	62,841	63,871	62,095
Diluted	64,128	64,494	63,871	64,278

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

Table of Contents

JOE S JEANS INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Nine months ended	
	August 31, 2011	August 31, 2010
	(unaudited)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net cash provided by (used in) operating activities	\$ 7,986	\$ (5,519)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property and equipment	(1,825)	(2,514)
Net cash used in investing activities	(1,825)	(2,514)
CASH FLOWS FROM FINANCING ACTIVITIES		
(Payments to) proceeds from factor borrowing, net	(411)	1,966
Proceeds from exercise of warrants		653
Proceeds from exercise of options		30
Taxes on net settled options exercised		(653)
Payment of taxes on restricted stock units	(519)	(595)
Net cash (used in) provided by financing activities	(930)	1,401
NET CHANGE IN CASH AND CASH EQUIVALENTS	5,231	(6,632)
CASH AND CASH EQUIVALENTS, at beginning of period	6,410	13,195
CASH AND CASH EQUIVALENTS, at end of period	\$ 11,641	\$ 6,563

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

Table of Contents

JOE S JEANS INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

(in thousands)

	Common Stock Shares	Common Stock Par Value	Additional Paid-In Capital	Accumulated Deficit	Treasury Stock	Total Stockholders Equity
Balance, November 30, 2009	61,494	\$ 6,151	\$ 103,605	\$ (45,450)	\$ (2,800)	\$ 61,506
Net income (unaudited)				1,784		1,784
Stock-based compensation, net of withholding taxes (unaudited)			690			690
Exercise of warrants (unaudited)	480	48	605			653
Net settled warrants exercised (unaudited)	86	9	(9)			
Exercise of stock options (unaudited)	60	6	24			30
Net settled options exercised (unaudited)	832	83	(83)			
Taxes on net settled options exercised (unaudited)			(653)			(653)
Issuance of restricted stock (unaudited)	834	84	(84)			
Balance, August 31, 2010 (unaudited)	63,786	\$ 6,381	\$ 104,095	\$ (43,666)	\$ (2,800)	\$ 64,010
Balance, November 30, 2010	64,131	\$ 6,415	\$ 104,364	\$ (42,849)	\$ (3,057)	\$ 64,873
Net loss (unaudited)				(1,097)		(1,097)
Stock-based compensation, net of withholding taxes (unaudited)			821			821
Issuance of restricted stock (unaudited)	1,028	103	(103)			
Balance, August 31, 2011 (unaudited)	65,159	\$ 6,518	\$ 105,082	\$ (43,946)	\$ (3,057)	\$ 64,597

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

Table of Contents

JOE S JEANS INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - BASIS OF PRESENTATION

The unaudited condensed consolidated financial statements of Joe s Jeans Inc., or Joe s, we or us, which include the accounts of our wholly-owned subsidiaries, for the three and nine months ended August 31, 2011 and 2010 and the related footnote information have been prepared on a basis consistent with our audited consolidated financial statements as of November 30, 2010 contained in our Annual Report on Form 10-K, or the Annual Report. Our fiscal year end is November 30.

Our principal business activity involves the design, development and worldwide marketing of apparel products. Our primary current operating subsidiary is Joe s Jeans Subsidiary Inc., or Joe s Jeans Subsidiary. All significant inter-company transactions have been eliminated. We operate in two primary business segments: Wholesale and Retail. Our Wholesale segment is comprised of sales to retailers, specialty stores and distributors and includes expenses from marketing, sales, distribution and customer service departments. Also, some international sales are made directly to wholesale customers who operate retail stores. Our Retail segment is comprised of sales to consumers through full-price retail stores, outlet stores and through the www.joesjeans.com/shop internet site. We opened our first full price retail store in October 2008 in Chicago, Illinois and currently operate four full price retail stores and 17 outlet stores in outlet centers around the country. Our Corporate and other is comprised of corporate operations, which include the executive, finance, legal, and human resources departments, design, production and general advertising expense to support the Joe s ® brand.

We, along with our Joe s Jeans Subsidiary, JD Holdings, Inc., or JD Holdings, and Joseph Dahan, the sole stockholder of JD Holdings, entered into a definitive Agreement and Plan of Merger on February 6, 2007, as amended on June 25, 2007, or the Merger Agreement. JD Holdings primary assets included all rights, title and interest in all intellectual property, including the trademarks, related to the Joe s®, Joe s Jeans and JD® brand and marks, or the Joe s Brand. JD Holdings was the successor to JD Design, the entity from whom we licensed the Joe s Brand. The license agreement terminated automatically upon completion of the merger. We acquired JD Holdings in order to acquire the Joe s Brand which allowed us to expand our product offerings and the brand in the marketplace, including opening branded retail stores and entering into licenses for additional product categories.

Under the terms and subject to the conditions set forth in the Merger Agreement, on October 25, 2007, we completed the merger. In connection with the merger, Joe s Subsidiary merged with and into JD Holdings, with Joe s Subsidiary as the surviving entity. In addition, we issued 14,000,000 shares of our common stock, made a cash payment of \$300,000 to JD Holdings in exchange for all of its outstanding shares and incurred \$269,000 of other costs related to the merger. As a result of the merger, we now own all outstanding stock of JD Holdings and all rights, title and interest in the Joe s Brand. Upon completion of the merger, on October 25, 2007, Mr. Dahan became one of our officers, directors and greater than 10 percent stockholder and an Employment Agreement and Investor Rights Agreement became effective.

These unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the related notes thereto contained in our Annual Report. In the opinion of management, the accompanying unaudited financial statements contain all adjustments (consisting of normal recurring adjustments), which management considers necessary to present fairly our financial position,

Edgar Filing: JOE'S JEANS INC. - Form 10-Q

results of operations and cash flows for the interim periods presented. The results for the three and nine months ended August 31, 2011 are not necessarily indicative of the results anticipated for the entire year ending November 30, 2011. The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements. Actual results may differ from those estimates.

Table of Contents**NOTE 2 ADOPTION OF ACCOUNTING PRINCIPLES**

There were no Financial Accounting Standards Board, or FASB, issued standard that we adopted in the relevant periods.

NOTE 3 ACCOUNTS RECEIVABLE, INVENTORY ADVANCES AND DUE TO FACTOR

Our primary method to obtain the cash necessary for operating needs has been through the sale of accounts receivable pursuant to factoring agreements and advances under inventory security agreements with our factor, CIT Commercial Services, a unit of CIT Group Inc., or CIT.

As a result of these agreements, amounts due to factor consist of the following (in thousands):

	August 31, 2011		November 30, 2010
Non-recourse receivables assigned to factor	\$ 14,010	\$	13,571
Client recourse receivables	122		146
Total receivables assigned to factor	14,132		13,717
Allowance for customer credits	(2,813)		(2,967)
Net loan balance from factored accounts receivable	(11,262)		(10,013)
Net loan balance from inventory advances	(4,618)		(5,709)
Due to factor	\$ (4,561)	\$	(4,972)
Non-factored accounts receivable	\$ 2,798	\$	3,263
Allowance for customer credits	(428)	\$	(440)
Allowance for doubtful accounts	(524)		(449)
Accounts receivable, net of allowance	\$ 1,846	\$	2,374

Of the total amount of receivables sold by us as of August 31, 2011 and November 30, 2010, we hold the risk of payment of \$122,000 and \$146,000, respectively, in the event of non-payment by the customers.

CIT Commercial Services

Our Joe's Jeans Subsidiary is party to an accounts receivable factoring agreement and an inventory security agreement with CIT. The accounts receivable agreement gives us the ability to obtain cash by selling to CIT certain of our accounts receivable and the inventory security agreement gives us the ability to obtain advances for up to 50 percent of the value of certain eligible inventory. The accounts receivables are sold for up to 85 percent of the face amount on either a recourse or non-recourse basis depending on the creditworthiness of the customer. CIT currently permits us to sell our accounts receivables at the maximum level of 85 percent and allows advances of up to \$6,000,000 for eligible inventory. CIT has the ability, in its discretion at any time or from time to time, to adjust or revise any limits on the amount of loans or advances made to us

Edgar Filing: JOE'S JEANS INC. - Form 10-Q

pursuant to both of these agreements and to impose surcharges on our rates for certain of our customers. In addition, cross guarantees were executed by and among us and all of our parent and subsidiaries to guarantee each entity's obligations. In connection with the agreements with CIT, certain assets are pledged to CIT, including all of the inventory, merchandise and/or goods, including raw materials through finished goods and receivables. However, our trademarks are not encumbered.

Table of Contents

In May 2010, the parties amended the accounts receivable agreement to provide for a change in the factoring fees, an extension of the agreement and additional termination rights. The accounts receivable agreement may be terminated by CIT upon 60 days written notice or immediately upon the occurrence of an event of default as defined in the agreement. The accounts receivable agreement may be terminated by us upon 60 days written notice prior to June 30, 2012, or earlier provided that the minimum factoring fees have been paid for the respective period or CIT fails to fund us for five consecutive days. The inventory agreement may be terminated once all obligations are paid under both agreements or if an event of default occurs as defined in the agreement.

From June 1 to June 30, 2010, we paid to CIT a factoring rate of 0.6 percent to factor accounts which CIT bore the credit risk, subject to discretionary surcharges, and 0.4 percent for accounts which Joe's bore the credit risk. The interest rate associated with borrowings under the inventory lines and factoring facility is 0.25 percent plus the Chase prime rate. Beginning July 1, 2010, the factoring rate changed to 0.55 percent for accounts which CIT bears the credit risk, subject to discretionary surcharges, up to \$40,000,000 of invoices factored, 0.50 percent over \$40,000,000 of invoices factored and 0.35 percent for accounts which we bear the credit risk. The interest rate associated with borrowings under the inventory lines and factoring facility is 0.25 percent plus the Chase prime rate. As of August 31, 2011, the Chase prime rate was 3.25 percent.

In the event we need additional funds, we have also established a letter of credit facility with CIT to allow us to open letters of credit for a fee of 0.25 percent of the letter of credit face value with international and domestic suppliers, subject to availability. At August 31, 2011, we did not have any letters of credit outstanding.

NOTE 4 INVENTORIES

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

	August 31, 2011		November 30, 2010
Finished goods	\$ 15,179	\$	23,347
Finished goods consigned to others	197		376
Work in progress	1,779		1,508
Raw materials	8,816		6,081
	25,971		31,312
Less allowance for obsolescence and slow moving items	(1,080)		(1,067)
	\$ 24,891	\$	30,245

We recorded charges to our inventory reserve allowance of \$128,000 for the three and nine month period ended August 31, 2011 and \$0 for the three and nine months ended August 31, 2010, respectively.

During the third quarter of fiscal 2011, we wrote down certain finished goods inventory by \$1,620,000, representing the lower of cost or market adjustment.

Table of Contents**NOTE 5 PROPERTY AND EQUIPMENT**

Property and equipment consisted of the following (in thousands):

	Useful lives (years)	August 31, 2011	November 30, 2010
Computer and equipment	3-7	\$ 1,699	\$ 1,600
Furniture and fixtures	3-7	2,332	1,930
Leasehold improvements, primarily retail	5-10	3,946	4,437
		7,977	7,967
Less accumulated depreciation		(2,462)	(2,246)
Net property and equipment		\$ 5,515	\$ 5,721

Depreciation and amortization expense related to property and equipment is recorded in operating expenses. For the three months ended August 31, 2011 and 2010, depreciation and amortization was \$323,000 and \$223,000, respectively, and for the nine months ended August 31, 2011 and 2010, was \$887,000 and \$604,000, respectively.

We identify indicators of impairment present at certain of our retail stores which are part of our retail segment (all located in the U.S). These indicators of impairment are specifically related to under-performance or operating losses relative to expected historical or projected future operating results. We perform a recoverability test and an impairment test on these stores. The key assumptions used in estimates of projected cash flows were sales, gross margins and payroll costs. These forecasts were based on historical trends and take into account recent developments, as well as our future plans and intentions. Based upon the results of the discounted cash flow analysis, which included the operating performance of certain of our stores, we recorded an impairment charge related to property and equipment at two of our full price retail stores of \$1,144,000 for both the three and nine months ended August 31, 2011 because we do not believe we can recover the carrying value of the property and equipment.

NOTE 6 RELATED PARTY TRANSACTIONS

As of August 31, 2011 and November 30, 2010, our related party balance consisted of amounts due to and due from certain related parties, as further described below, as follows (in thousands):

	August 31, 2011	November 30, 2010
Due from related parties		
Kids Jeans LLC	\$	\$ 13
Albert Dahan		25
Total due from related parties	\$	\$ 38
Due to related parties		
Joe Dahan	\$ 403	\$ 333

Edgar Filing: JOE'S JEANS INC. - Form 10-Q

Albert Dahan		35		
Total due to related parties	\$	438	\$	333

Joe Dahan

As part of the consideration paid in connection with the merger, Mr. Dahan is entitled to a certain percentage of our gross profit in any applicable fiscal year until October 2017. See Note 9 - Contingent Consideration Payments for a further discussion on the contingent consideration.

For the three months ended August 31, 2011 and 2010, expenses of \$439,000 and \$441,000, respectively, and nine months ended August 31, 2011 and 2010, expenses of \$1,342,000 and \$1,363,000, respectively, were recorded in the statement of income related to the contingent consideration payments made to Mr. Dahan under this agreement.

Table of Contents*Albert Dahan*

In April 2009, we entered into a commission-based sales agreement with Albert Dahan, brother of Joe Dahan, for the sale of our products into the off-price channels of distribution. Under the agreement, Mr. Albert Dahan is entitled to a commission for purchase orders entered into by us where he acts as a sales person. The agreement may be terminated at any time for any reason or no reason with or without notice. For the three months ended August 31, 2011 and 2010, payments of \$165,000, and \$226,000, respectively, and for the nine months ended August 31, 2011 and 2010, payments of \$546,000 and \$619,000, respectively, were made to Mr. Albert Dahan under this arrangement.

Effective as of June 1, 2009, we entered into a license agreement for the license of the children's product line with Kids Jeans LLC, or Kids LLC, an entity in which Mr. Albert Dahan holds an interest and has voting control. Under the terms of the license, Kids LLC had an exclusive right to produce, distribute and sell children's products bearing the Joe's® brand on a worldwide basis, subject to certain limitations on the channels of distribution. In exchange for the license, Kids LLC paid us a royalty payment of 20 percent on the first \$5,000,000 in net sales, or \$1,000,000. In April 2011, we terminated the license agreement and in June 2011, we entered into a settlement agreement with Kids LLC. Pursuant to the terms of the settlement agreement, Kids LLC agreed to pay to us approximately \$450,000 in exchange for Kids LLC's right to continue to sell children's apparel products until September 30, 2011 or December 31, 2011, depending on the product to be sold and customer to whom it will be sold. In exchange, the parties entered into mutual releases with respect to all claims related to the subject matter.

NOTE 7 EARNINGS PER SHARE

Earnings per share are computed using weighted average common shares and dilutive common equivalent shares outstanding. Potentially dilutive securities consist of outstanding options, restricted stock and unvested RSUs. A reconciliation of the numerator and denominator of basic earnings per share and diluted earnings per share is as follows:

	Three months ended (in thousands, except per share data)		Nine months ended (in thousands, except per share data)	
	August 31, 2011	August 31, 2010	August 31, 2011	August 31, 2010
Basic earnings per share computation:				
Numerator:				
Net (loss) income	\$ (2,038)	\$ 558	\$ (1,097)	\$ 1,784
Denominator:				
Weighted average common shares outstanding	64,128	62,841	63,871	62,095
(Loss) income per common share - basic				
Net income	\$ (0.03)	\$ 0.01	\$ (0.02)	\$ 0.03
Diluted earnings per share computation:				
Numerator:				
Net (loss) income	\$ (2,038)	\$ 558	\$ (1,097)	\$ 1,784
Denominator:				
Weighted average common shares outstanding	64,128	62,841	63,871	62,095
Effect of dilutive securities:				
Restricted shares, RSUs and options		1,653		2,183
Dilutive potential common shares	64,128	64,494	63,871	64,278
(Loss) income per common share - dilutive				

Edgar Filing: JOE'S JEANS INC. - Form 10-Q

Net (loss) income	\$	(0.03)	\$	0.01	\$	(0.02)	\$	0.03
-------------------	----	--------	----	------	----	--------	----	------

For the three and nine months ended August 31, 2010, currently exercisable options, unvested restricted shares and unvested RSUs in the aggregate of 450,000 have been excluded from the calculation of diluted income per share because the exercise prices of such options and unvested restricted shares and RSUs were out-of-the-money.

Table of Contents

For the three and nine months ended August 31, 2011, currently exercisable options, unvested restricted shares and unvested RSUs in the aggregate of 4,415,843 have been excluded from the calculation of the diluted loss per share as their effect would have been anti-dilutive.

Shares Reserved for Future Issuance

As of August 31, 2011, shares reserved for future issuance include (i) 868,290 shares of common stock issuable upon the exercise of stock options granted under the incentive plans; (ii) 2,878,514 shares of common stock issuable upon the vesting of RSUs; and (iii) an aggregate of 2,968,512 shares of common stock available for future issuance under the 2004 Stock Incentive Plan.

NOTE 8 INCOME TAXES

We utilize the liability method of accounting for income taxes in accordance with FASB Accounting Standards Codification, or ASC, 740. Under the liability method, deferred taxes are determined based on the temporary differences between the financial statements and tax bases of assets and liabilities using enacted tax rates.

Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized. The likelihood of a material change in our expected realization of these assets depends on our ability to generate sufficient future taxable income. Our ability to generate enough taxable income to utilize our deferred tax assets depends on many factors, among which is our ability to deduct tax loss carry-forwards against future taxable income, the effectiveness of tax planning strategies and reversing deferred tax liabilities.

We are subject to U.S. federal income tax as well as income tax in multiple state jurisdictions. To the extent allowed by law, the tax authorities may have the right to examine prior periods where net operating losses were generated and carried forward, and make adjustments up to the amount of the net operating loss carryforward amount. We are no longer subject to U.S. federal and California income tax examinations by tax authorities for years prior to 2006. Our federal income tax return for fiscal 2009 is currently under examination by the Internal Revenue Service, or IRS. We do not expect this examination will have a material effect on our financial statements or results of operations upon conclusion of examination. There are currently no other examinations pending with any other jurisdictions.

We had net operating loss carryforwards of \$40,144,000 at the end of fiscal 2010 for federal tax purposes that will expire through 2026. We also had \$25,489,000 of net operating loss carryforwards available for California which begin to expire in 2014.

Certain limitations may be placed on net operating loss carryforwards as a result of changes in control as defined in Section 382 of the Internal Revenue Code. In the event a change in control occurs, it will have the effect of limiting the annual usage of the carryforwards in future years. Additional changes in control in future periods could result in further limitations of our ability to offset taxable income. Management believes that certain changes in control have occurred which resulted in limitations on our net operating loss carryforwards.

NOTE 9 STOCKHOLDERS EQUITY

Stock Incentive Plans

In September 2000, we adopted the 2000 Director Stock Incentive Plan, or the 2000 Director Plan, under which nonqualified stock options were granted to members of our Board of Directors in lieu of cash director fees. After the adoption of the 2004 Stock Incentive Plan in June 2004, we no longer granted options pursuant to the 2000 Director Plan; however, the plan remains in effect for awards outstanding as of the adoption of the 2004 Stock Incentive Plan. As of August 31, 2011, options to purchase up to 93,290 shares of common stock remained outstanding under the 2000 Director Plan.

Table of Contents

On June 3, 2004, we adopted the 2004 Stock Incentive Plan, or the 2004 Incentive Plan, and have amended it to increase the number of shares authorized for issuance to 12,265,172 shares of common stock. Under the 2004 Incentive Plan, grants may be made to employees, officers, directors and consultants under a variety of awards based upon underlying equity, including, but not limited to, stock options, restricted common stock, restricted stock units or performance shares. The 2004 Incentive Plan limits the number of shares that can be awarded to any employee in one year to 1,250,000. The exercise price for incentive options may not be less than the fair market value of our common stock on the date of grant and the exercise period may not exceed ten years. Vesting periods, terms and types of awards are determined by the Board of Directors and/or our Compensation and Stock Option Committee, or Compensation Committee. The 2004 Incentive Plan includes a provision for the acceleration of vesting of all awards upon a change of control as well as a provision that allows forfeited or unexercised awards that have expired to be available again for future issuance. Since fiscal 2008, we have issued both restricted common stock and restricted common stock units, or RSUs, to our officers, directors and employees pursuant to the 2004 Incentive Plan. The RSUs represent the right to receive one share of common stock for each unit on the vesting date provided that the employee continues to be employed by us. On the vesting date of the RSUs, we expect to issue the shares of common stock to each participant upon vesting and expect to withhold an equivalent number of shares at fair market value on the vesting date to fulfill tax withholding obligations. Any RSUs withheld or forfeited will be shares available for issuance in accordance with the terms of the 2004 Incentive Plan.

The shares of common stock issued upon exercise of a previously granted stock option or a grant of restricted common stock or RSUs are considered new issuances from shares reserved for issuance in connection with the adoption of the various plans. We require that the option holder provide a written notice of exercise in accordance with the option agreement and plan to the stock plan administrator and full payment for the shares be made prior to issuance. All issuances are made under the terms and conditions set forth in the applicable plan. As of August 31, 2011, 2,968,512 shares remained available for issuance under the 2004 Incentive Plan. At our annual stockholder's meeting to be held on October 26, 2011, we are asking our stockholders to approve the adoption of an Amended and Restated 2004 Stock Incentive Plan, or the Restated Plan. The Restated Plan is similar to the 2004 Stock Incentive Plan, but has been updated to reflect changes in the tax code since its original adoption and to qualify for deductibility under Section 162(m) of the Internal Revenue Code for certain grants of performance based compensation pursuant to pre-established performance goals. If the Restated Plan is approved, we will no longer grant shares under the 2004 Incentive Plan and all future grants will be made pursuant to the Restated Plan. We have asked our stockholders to approve the reserve for issuance of up to 6,825,000 shares of common stock under the Restated Plan.

For all stock compensation awards that contain graded vesting with time-based service conditions, we have elected to apply a straight-line recognition method to account for all of these awards. For existing grants that were not fully vested at November 30, 2010, there was a total of \$487,000 and \$1,340,000 of stock based compensation expense recognized during the three and nine months ended August 31, 2011, respectively.

Table of Contents

The following summarizes option grants, restricted common stock and RSUs issued to members of the Board of Directors for the fiscal years 2002 through the third quarter of fiscal 2011 (in actual amounts) for service as a member:

Granted as of:	August 31, 2011		Exercise price
	Number of options		
2002	40,000	\$	1.00
2002	31,496	\$	1.27
2003	30,768	\$	1.30
2004	320,000	\$	1.58
2005	300,000	\$	5.91
2006	450,000	\$	1.02

	Number of restricted shares issued
2007	320,000
2008	473,455
2009	371,436
2010	131,828
2011	

Exercise prices for options outstanding as of August 31, 2011 are as follows:

Exercise Price	Options Outstanding and Exercisable	
	Number of shares	Weighted-Average Remaining Contractual Life
\$1.00 - \$1.02	140,000	3.4
\$1.27 - \$1.30	53,290	1.4
\$1.58 - \$1.63	225,000	3.0
\$5.91	450,000	3.8
	868,290	3.4

Table of Contents

The following table summarizes the stock option activity by plan for the respective periods (in actual amounts):

	Total Number of Shares	2004 Incentive Plan	2000 Director Plan
Outstanding at November 30, 2010	868,290	775,000	93,290
Granted			
Exercised			
Forfeited / Cancelled			
Outstanding and exercisable at August 31, 2011	868,290	775,000	93,290
Outstanding at November 30, 2009	3,226,046	3,022,500	203,546
Granted			
Exercised	(2,306,474)	(2,247,500)	(58,974)
Forfeited / Cancelled			
Outstanding and exercisable at August 31, 2010	919,572	775,000	144,572

Table of Contents

Stock activity in the aggregate for the periods indicated are as follows (in actual amounts):

	Options	Weighted average exercise price	Weighted average remaining contractual Life (Years)	Aggregate Intrinsic Value
Outstanding at November 30, 2010	868,290	\$ 3.73		
Granted				
Exercised				
Expired				
Forfeited				
Outstanding and exercisable at August 31, 2011	868,290	\$ 3.73	3.4	\$
Weighted average per option fair value of options granted during the year		N/A		
	Options	Weighted average exercise price	Weighted average remaining contractual Life (Years)	Aggregate Intrinsic Value
Outstanding at November 30, 2009	3,226,046	\$ 1.78		
Granted				
Exercised	(2,306,474)	1.08		
Expired				
Forfeited				
Outstanding and exercisable at August 31, 2010	919,572	\$ 3.54	4.1	\$ 258,791
Weighted average per option fair value of options granted during the year		N/A		

As of August 31, 2011, there was \$2,985,000 of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the 2004 Incentive Plan. That unrecognized compensation cost is expected to be recognized over a weighted-average period of 2.3 years.

Table of Contents

A summary of the status of restricted common stock and RSUs as of November 30, 2009 and November 30, 2010, and changes during the nine months ended August 31, 2010 and 2011, respectively, are presented below:

	Restricted Shares	Restricted Stock Units	Total Shares	Weighted-Average Grant-Date Fair Value	
				Restricted Shares	Restricted Stock Units
Outstanding at November 30, 2010	408,857	3,126,967	3,535,824	\$ 0.86	\$ 0.90
Granted	260,182	959,331	1,219,513	1.65	1.15
Vested					
Issued		(767,943)	(767,943)		1.03
Cancelled		(439,841)	(439,841)		0.91
Forfeited					
Outstanding at August 31, 2011	669,039	2,878,514	3,547,553	\$ 1.17	\$ 0.95
Outstanding at November 30, 2009	691,903	4,773,979	5,465,882	\$ 0.94	\$ 0.84
Granted					
Vested					
Issued		(835,200)	(835,200)		0.79
Cancelled		(318,957)	(318,957)		0.84
Forfeited		(119,030)	(119,030)		0.98
Outstanding at August 31, 2010	691,903	3,500,792	4,192,695	\$ 0.94	\$ 0.84

In the three months ended August 31, 2011, we did not grant any shares of restricted stock or RSUs. In the three months ended August 31, 2011, we issued 414,131 shares of its common stock to holders of RSUs and we withheld or canceled 240,080 RSUs. In the nine months ended August 31, 2011, there were 1,219,513 shares of restricted stock or RSUs granted. In the nine months ended August 31, 2011, we issued 767,943 shares of its common stock to holders of RSUs, respectively, and withheld or cancelled 439,841 RSUs.

NOTE 10 COMMITMENTS AND CONTINGENCIES*Contingent Consideration Payments*

As part of the consideration paid in connection with the merger and without regard to continued employment, Mr. Dahan is entitled to a certain percentage of the gross profit earned by us in any applicable fiscal year until October 2017. Mr. Dahan is entitled to the following: (i) 11.33 percent of the gross profit from \$11,251,000 to \$22,500,000; (ii) three percent of the gross profit from \$22,501,000 to \$31,500,000; (iii) two percent of the gross profit from \$31,501,000 to \$40,500,000; (iv) one percent of the gross profit above \$40,501,000. The payments may be paid in advance on a monthly basis based upon estimates of gross profits after the assumption has been reached that the payments are likely to be paid. At the end of each quarter, any overpayments are offset against future payments and any significant underpayments are made. No payments are made if the gross profit is less than \$11,250,000. Gross Profit is defined as net sales of the Joe's® brand less cost of goods sold. See Note 5 Related Party Transactions for payments made to Mr. Dahan.

Retail Leases

We lease retail store locations under operating lease agreements expiring on various dates through 2023 or 5 to 10 years from the rent commencement date and have one temporary space for a term of nine months. Some of these leases require us to make periodic payments for property taxes, utilities and common area operating expenses. Certain retail store leases provide for rents based upon the minimum annual rental amount and a percentage of annual sales volume, generally ranging from 6% to 8%, when specific sales volumes are exceeded. Some leases include lease incentives, rent abatements and fixed rent escalations, which are amortized and recorded over the initial lease term on a straight-line basis.

Table of Contents

As of August 31, 2011, the future minimum rental payments under non-cancelable retail operating leases with lease terms in excess of one year were as follows (in thousands):

2011 Remainder of the year	\$	924
2012		3,745
2013		3,988
2014		4,253
2015		4,390
Thereafter		20,086
	\$	37,386

NOTE 11 SEGMENT INFORMATION

The following table contains summarized financial information concerning our reportable segments:

	Three months ended		Nine months ended	
	August 31, 2011	August 31, 2010	August 31, 2011	August 31, 2010
	(dollar values in thousands)			
Net sales:				
Wholesale	\$ 19,705	\$ 21,349	\$ 57,389	\$ 65,655
Retail	4,446	4,185	12,643	8,956
	\$ 24,151	\$ 25,534	\$ 70,032	\$ 74,611
Gross Profit:				
Wholesale	\$ 6,754	\$ 9,498	\$ 23,222	\$ 29,285
Retail	2,990	2,304	8,428	5,384
	\$ 9,744	\$ 11,802	\$ 31,650	\$ 34,669
Operating income (loss):				
Wholesale	\$ 3,135	\$ 5,741	\$ 13,285	\$ 17,738
Retail	(1,248)	(10)	(1,224)	103
Corporate and other	(4,529)	(4,222)	(12,495)	(13,762)
	\$ (2,642)	\$ 1,509	\$ (434)	\$ 4,079

	Nine months ended	
	August 31, 2011	August 31, 2010
Capital expenditures:		
Wholesale	\$ 249	\$ 23
Retail	1,513	2,399
Corporate and other	63	92
	\$ 1,825	\$ 2,514

	August 31, 2011	November 30, 2010
Total assets:		
Wholesale	\$ 45,457	\$ 45,594

Edgar Filing: JOE'S JEANS INC. - Form 10-Q

Retail	7,679	7,980
Corporate and other	28,103	27,895
	\$ 81,239	\$ 81,469

Table of Contents

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

Forward-Looking Statements

When used in this Quarterly Report on Form 10-Q, or Quarterly Report, the words may, will, expect, anticipate, intend, estimate, continue, believe and similar expressions are intended to identify forward-looking statements. Similarly, statements that describe our future expectations, objectives and goals or contain projections of our future results of operations or financial condition are also forward-looking statements. Statements looking forward in time are included in this Quarterly Report pursuant to the safe harbor provision of the Private Securities Litigation Reform Act of 1995. Such statements are subject to certain risks and uncertainties, which could cause actual results to differ materially, including, without limitation, continued acceptance of our product, product demand, competition, capital adequacy and the potential inability to raise additional capital if required, and the risk factors contained in our reports filed with the Securities and Exchange Commission, or SEC, pursuant to the Securities Exchange Act of 1934, as amended, or Exchange Act, including our Annual Report on Form 10-K for the year ended November 30, 2010. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. Our future results, performance or achievements could differ materially from those expressed or implied in these forward-looking statements. We do not undertake any obligation to publicly revise these forward-looking statements to reflect events or circumstances occurring after the date hereof or to reflect the occurrence of unanticipated events, except as required by law.

Introduction

This discussion and analysis summarizes the significant factors affecting our results of operations and financial conditions during the three and nine month period ended August 31, 2011 and 2010. This discussion should be read in conjunction with our Condensed Consolidated Financial Statements, Notes to Condensed Consolidated Financial Statements and supplemental information contained in this Quarterly Report.

Executive Overview

Our principal business activity is the design, development and worldwide marketing of our Joe's® products, which include denim jeans, related casual wear and accessories. Since Joe's® was established in 2001, the brand is recognized in the premium denim industry, an industry term for denim jeans with price points generally of \$120 or more, for its quality, fit and fashion-forward designs. Because we focus on design, development and marketing, we rely on third parties to manufacture our apparel products. We sell our products through our own retail stores and to numerous retailers, which include major department stores, specialty stores and distributors around the world.

The focus of our operations has been on our Joe's® brand. To enhance our ability to capitalize on the Joe's® brand, on February 6, 2007, we entered into a merger agreement to merge with JD Holdings, the successor in interest to JD Design LLC, or JD Design, the entity from whom we licensed the Joe's® brand. We also entered into our first license agreement for other product categories for handbags and small leather goods bearing the Joe's® brand. In October 2007, we completed the merger and acquired JD Holdings. In exchange for JD Holdings, we issued 14,000,000 shares of our common stock and \$300,000 in cash. As part of the merger consideration, we are obligated to pay Mr. Dahan a percentage of our gross profits above \$11,251,000 until 2017. Mr. Dahan will be entitled to the following: (i) 11.33 percent of the gross profit from \$11,251,000 to \$22,500,000; (ii) 3 percent of the gross profit from \$22,501,000 to \$31,500,000; (iii) 2 percent of the gross profit from \$31,501,000 to \$40,500,000; and (iv) 1 percent of the gross profit above \$40,501,000. Concurrently, we entered into an employment agreement

Edgar Filing: JOE'S JEANS INC. - Form 10-Q

with Joe Dahan to serve as one of our executive officers. Mr. Dahan is our largest stockholder. As of October 11, 2011, he owned approximately 18 percent of our total shares outstanding and also is a member of our Board of Directors.

Beginning in 2009, we began to re-examine our collection pieces and re-launched several product categories with their own unique branding along with the Joe's® logo or name. In the fall of fiscal 2009, we launched a line of unisex woven shirts in different fits and fabrications called The Shirt by Joe's, which was followed by items in other distinct product categories. For the Fall of 2011, we will return to branding our products cohesively under the name Joe's®. We believe that offering other products, such as tees, tops and non-denim bottoms, when added to our core and fashion denim, will be a growth driver for our overall business in fiscal 2011.

Table of Contents

For the remainder of 2011, we believe that our growth drivers will be dependent upon the performance of our retail stores, continued improvement in our men's sales, performance of our licensees under their respective agreements, including international retail store agreements, and enhancement of the products available to our customers branded with our Joe's name and logos, including tees, tops and non-denim bottoms. At the beginning of fiscal 2010, we operated two full price stores and four outlet stores. Currently, we operate five full price retail stores and 17 outlet stores. We continue to look for additional leases for further expansion. We believe that through our retail stores, we are able to enhance our net sales and gross profit and sell overstock or slow moving items at higher profit margins. In addition, we selectively license the Joe's® brand for other product categories, such as children's products, shoes, handbags and belts. By licensing certain product categories, we do not incur significant capital investments or incremental operating expenses and at the same time, we receive royalty payments on net sales, which contribute to our overall growth.

Our business is seasonal. The majority of the marketing and sales orders take place from late fall to early spring. The greatest volume of shipments and actual sales are generally made from late spring through the summer, which coincides with our second and third fiscal quarters, and our cash flow is strongest in our third and fourth fiscal quarters. Due to the seasonality of our business, as well as the evolution and changes in our business and product mix, often our quarterly or yearly results are not necessarily indicative of the results for the next quarter or year. However, because of the limited number of full price retail and outlet stores open during the first quarter of fiscal 2010 and the growing number of full-price retail and outlet stores opened thereafter, we continue to assess the seasonality of our business on our retail segment and its potential impact on our financial results.

We operate in two primary business segments: Wholesale and Retail. Our Wholesale segment is comprised of sales to retailers, specialty stores and distributors and includes expenses from marketing, sales, distribution and customer service departments. Also, some international sales are made directly to wholesale customers who operate retail stores. Our Retail segment is comprised of sales to consumers through full-price retail stores, outlet stores and through the www.joesjeans.com/shop internet site. Our Corporate and other is comprised of corporate operations, which include the executive, finance, legal, and human resources departments, design, production and general advertising expense to support the Joe's® brand.

Table of Contents**Comparison of Three Months Ended August 31, 2011 to Three Months Ended August 31, 2010**

	Three months ended (dollar values in thousands)			
	August 31, 2011	August 31, 2010	\$ Change	% Change
Net sales	\$ 24,151	\$ 25,534	\$ (1,383)	(5)%
Cost of goods sold	14,407	13,732	675	5%
Gross profit	9,744	11,802	(2,058)	(17)%
Gross margin	40%	46%		
Selling, general & administrative	10,919	10,070	849	8%
Depreciation & amortization	323	223	100	45%
Retail stores impairment	1,144		1,144	N/A
Operating (loss) income	(2,642)	1,509	(4,151)	(275)%
Interest expense	111	113	(2)	(2)%
(Loss) income before provision for taxes	(2,753)	1,396	(4,149)	(297)%
Income tax (benefit) expense	(715)	838	(1,553)	(185)%
Net (loss) income	\$ (2,038)	\$ 558	\$ (2,596)	(465)%

Three Months Ended August 31, 2011 Overview

The following table sets forth certain statements of operations data by our reportable segments for the periods as indicated:

	Three months ended (dollar values in thousands)			
	August 31, 2011	August 31, 2010	\$ Change	% Change
Net sales				
Wholesale	\$ 19,705	\$ 21,349	\$ (1,644)	(8)%
Retail	4,446	4,185	261	6%
	\$ 24,151	\$ 25,534	\$ (1,383)	(5)%
Gross Profit:				
Wholesale	\$ 6,754	\$ 9,498	\$ (2,744)	(29)%
Retail	2,990	2,304	686	30%
	\$ 9,744	\$ 11,802	\$ (2,058)	(17)%
Operating income (loss):				
Wholesale	\$ 3,135	\$ 5,741	\$ (2,606)	(45)%
Retail	(1,248)	(10)	(1,238)	(12,380)%
Corporate and other	(4,529)	(4,222)	(307)	(7)%
	\$ (2,642)	\$ 1,509	\$ (4,151)	(275)%

Table of Contents

For the three months ended August 31, 2011, or the third quarter of fiscal 2011, our net sales decreased to \$24,151,000 from \$25,534,000 for the three months ended August 31, 2010, or the third quarter fiscal 2010, a five percent decrease. We had an operating loss of \$2,642,000 for the third quarter of fiscal 2011 compared to operating income of \$1,509,000 for the third quarter of fiscal 2010, a 275 percent decrease.

Net Sales

Our net sales decreased to \$24,151,000 for the third quarter of fiscal 2011 from \$25,534,000 for the third quarter of fiscal 2010, a five percent decrease.

More specifically, our wholesale net sales decreased to \$19,705,000 for the third quarter of fiscal 2011 from \$21,349,000 for the third quarter of fiscal 2010, an eight percent decrease. This decrease in our wholesale sales is primarily attributed to a decrease in international and women's domestic sales, which declined collectively by \$3,261,000 over the prior year period, or a 18 percent decrease. This decrease was partially offset by a \$1,314,000, or a 40 percent increase, in men's domestic sales.

Our retail net sales increased to \$4,446,000 for the third quarter of fiscal 2011 from \$4,185,000 for the third quarter of fiscal 2010, a six percent increase. The primary driver for this increase was the positive impact of additional sales due to the opening of seven additional stores between the end of the third quarter of fiscal 2010 and the end of our third quarter of fiscal 2011.

Gross Profit

Our gross profit decreased to \$9,744,000 for the third quarter of fiscal 2011 from \$11,802,000 for the third quarter of fiscal 2010, a 17 percent decrease. Our overall gross margin decreased to 40 percent for the third quarter of fiscal 2011 compared to 46 percent for the third quarter of fiscal 2010. Our gross profit and gross margin for the third quarter of fiscal 2011 was negatively impacted by a write down of \$1,620,000 to market value for leggings and collection inventory. This inventory write down accounted for 14 percent of the 17 percent decline in the current quarter's gross profit and resulted in a gross margin reduction of seven percentage points.

Our wholesale gross profit decreased to \$6,754,000 for the third quarter of fiscal 2011 from \$9,498,000 for the third quarter of fiscal 2010, a 29 percent decrease due to write down of \$1,620,000 in the carrying value of certain finished goods inventory to market and a decrease of \$1,644,000 in wholesale sales. This inventory write down reduced our wholesale gross profit for the third quarter of fiscal 2011 by approximately 19 percent and resulted in a gross margin reduction of eight percentage points. Our wholesale gross margins for the third quarter of fiscal 2011 were further impacted by our product placement mix with our wholesale customers.

Our retail gross profit increased \$2,990,000 for the third quarter of fiscal 2011 from \$2,304,000 for the third quarter of fiscal 2010, a 30 percent increase, due primarily to a 12 percentage point increase in gross margin. We undertook a high level of promotional activity during the third quarter of fiscal 2010 which resulted in gross margins of 55 percent compared to gross margins of 67 percent for the third quarter of fiscal 2011.

Selling, General and Administrative Expense, including Depreciation and Amortization and Retail Store Impairment

Selling, general and administrative, or SG&A, expenses increased to \$12,386,000 for the third quarter of fiscal 2011 from \$10,293,000 for the third quarter of fiscal 2010, a twenty percent increase. Our SG&A include expenses related to employee and employee related benefits, sales commissions, payments of the contingent consideration in connection with the merger with JD Holdings, advertising, sample production, facilities and distribution related costs, professional fees, stock-based compensation, factor and bank fees and also includes depreciation and amortization and retail store impairment. In the third quarter of fiscal 2011, we recorded a retail store impairment charge of \$1,144,000 related to the property and equipment at two of our full price retail stores. Based on the operating performance of these stores, we believed that we could not recover the carrying value of the property and equipment at these stores. Due to this impairment, our SG&A expenses increased correspondingly for the third quarter of fiscal 2011.

Table of Contents

Our wholesale SG&A expense decreased to \$3,619,000 for the third quarter of fiscal 2011 from \$3,757,000 for the third quarter of fiscal 2010, a four percent decrease. Our wholesale SG&A expense was lower in the third quarter of fiscal 2011 mostly due to lower sample and distribution expenses. Cost savings in these areas resulted from close management of our sample expenses and consolidating our distribution function to our corporate facility in the first quarter of fiscal 2011.

Our retail SG&A expense increased to \$4,238,000 for the third quarter of fiscal 2011 from \$2,314,000 for the third quarter of fiscal 2010, a 83 percent increase. Our retail SG&A expense increased due to the addition of costs associated with opening and operating seven additional stores between the end of the third quarter of fiscal 2010 and the end of our third quarter of fiscal 2011 and an impairment charge of \$1,144,000 related to the property and equipment at two of our full price retail stores. Due to this impairment, our retail SG&A expenses increased correspondingly for the third quarter of fiscal 2011.

Our corporate and other SG&A expense increased to \$4,529,000 in the third quarter of fiscal 2011 from \$4,222,000 for the third quarter of fiscal 2010, a seven percent increase. Our corporate and other SG&A expense includes general overhead associated with running our operations. Our increase in corporate and other SG&A expenses was primarily attributable to increased expenses in print and other advertising in order to support and promote our brand and increased professional fees.

Operating Income

We had an operating loss of \$2,642,000 for the third quarter of fiscal 2011 compared to operating income of \$1,509,000 for the third quarter of fiscal 2010, a 275 percent decrease. We experienced an operating loss compared to operating income mostly due to the impairment charge of \$1,144,000 related to the property and equipment at two of our full price retail stores and the write down of \$1,620,000 to market value for leggings and collection inventory.

Our wholesale operating income decreased to \$3,135,000 for the third quarter of fiscal 2011 from \$5,741,000 for the third quarter of fiscal 2010, a 45 percent decrease. Our retail operating loss was \$1,248,000 compared to a loss of \$10,000 for the third quarter of fiscal 2010. Corporate operating income increased by \$307,000 to \$4,529,000 from \$4,222,000, contributing to our operating loss.

Interest Expense

Our combined interest expense decreased to \$111,000 for the third quarter of fiscal 2011 from \$113,000 for the third quarter of fiscal 2010, a two percent decrease. Our interest expense is primarily associated with interest expense from our factoring facility and inventory lines of credit used to help support our working capital needs. We maintained comparable average loan balances under our factoring facility in both comparative periods.

Income Tax

Edgar Filing: JOE'S JEANS INC. - Form 10-Q

Our effective tax rate was a benefit of 26 percent for the third quarter of fiscal 2011 compared to an expense of 60 percent in the third quarter of 2010. The income tax benefit for the third quarter of fiscal 2011 resulted from losses associated with our operations in the current quarter. Differences in our effective tax rate between the comparative periods are primarily due to permanent tax deduction limitations related to executive compensation and the permanent book/tax difference associated with the costs of acquiring the trademark (in connection with the merger in 2007) remaining constant while estimated pre-tax income (loss) varied.

Table of Contents**Net (Loss) Income**

Our net loss was \$2,038,000 in the third quarter of fiscal 2011 compared to net income \$558,000 for the third quarter of fiscal 2010. This shift from net income to a net loss was primarily due to the write down of \$1,620,000 to market value for certain finished goods inventory and an impairment charge of \$1,144,000 related to the property and equipment at two of our full price retail stores.

Comparison of Nine Months Ended August 31, 2011 to Nine Months Ended August 31, 2010

	Nine months ended (dollar values in thousands)			
	August 31, 2011	August 31, 2010	\$ Change	% Change
Net sales	\$ 70,032	\$ 74,611	\$ (4,579)	(6)%
Cost of goods sold	38,382	39,942	(1,560)	(4)%
Gross profit	31,650	34,669	(3,019)	(9)%
Gross margin	45%	46%		
Selling, general & administrative	30,053	29,986	67	0%
Depreciation & amortization	887	604	283	47%
Retail stores impairment	1,144		1,144	N/A
Operating (loss) income	(434)	4,079	(4,514)	(111)%
Interest expense	365	329	36	11%
(Loss) income before provision for taxes	(799)	3,750	(4,549)	(121)%
Income tax (benefit) expense	298	1,966	(1,668)	(85)%
Net (loss) income	\$ (1,097)	\$ 1,784	\$ (2,881)	(161)%

Table of Contents**Nine Months Ended August 31, 2011 Overview**

The following table sets forth certain statements of operations data by our reportable segments for the periods as indicated:

	Nine months ended (dollar values in thousands)				
	August 31, 2011	August 31, 2010	\$ Change	% Change	
Net sales					
Wholesale	\$ 57,389	\$ 65,655	\$ (8,266)	(13)%	
Retail	12,643	8,956	3,687	41%	
	\$ 70,032	\$ 74,611	\$ (4,579)	(6)%	
Gross Profit:					
Wholesale	\$ 23,222	\$ 29,285	\$ (6,063)	(21)%	
Retail	8,428	5,384	3,044	57%	
	\$ 31,650	\$ 34,669	\$ (3,019)	(9)%	
Operating income (loss):					
Wholesale	\$ 13,285	\$ 17,738	\$ (4,453)	(25)%	
Retail	(1,224)	103	(1,327)	1,288%	
Corporate and other	(12,495)	(13,762)	1,267	9%	
	\$ (434)	\$ 4,079	\$ (4,513)	(111)%	

For the nine months ended August 31, 2011, our net sales decreased to \$70,032,000 from \$74,611,000 for the nine months ended August 31, 2010, a six percent decrease. We had an operating loss in the amount of \$434,000 for the nine months ended August 31, 2011 compared to operating income of \$4,079,000 for the nine months ended August 31, 2010.

Net Sales

Our net sales decreased to \$70,032,000 for the nine months ended August 31, 2011 compared to \$74,611,000 for the nine months ended August 31, 2010, a six percent decrease.

More specifically, our wholesale net sales decreased to \$57,389,000 for the nine months ended August 31, 2011 from \$65,655,000 for the nine months ended August 31, 2010, a 13 percent decrease. This decrease in our wholesale sales can be attributed to a decrease in overall sales in our women's domestic channels and more particularly, a decrease in sales of leggings, shirts and pants that performed at a lower level for us in the nine months ended August 31, 2011 compared to the same period in 2010.

Our retail net sales increased to \$12,643,000 for the nine months ended August 31, 2011 from \$8,956,000 for the nine months ended August 31, 2010, a 41 percent increase. The primary driver for this increase was the positive impact of additional sales due to the opening of seven

additional stores between the end of the third quarter of fiscal 2010 and the end of our third quarter of fiscal 2011.

Gross Profit

Our gross profit decreased to \$31,650,000 for the nine months ended August 31, 2011 from \$34,669,000 for the nine months ended August 31, 2010, a nine percent decrease. Our overall gross margin decreased to 45 percent for the nine months ended August 31, 2011 from 46 percent for the nine months ended August 31, 2010. This decrease in our overall gross profit and gross margin was due to the impact of the write down of \$1,620,000 to market value for leggings and collection inventory in the third quarter of fiscal 2011.

Table of Contents

Our wholesale gross profit decreased to \$23,222,000 for the nine months ended August 31, 2011 from \$29,285,000 for the nine months ended August 31, 2010, a 21 percent decrease. This decrease is primarily attributable to a \$6,063,000 decrease in our wholesale net sales and the write down of \$1,620,000 to market value for leggings and collection inventory in the third quarter of fiscal 2011. This inventory write down accounted for six percent of the 21 percent decline in the gross profit for the nine months ended August 31, 2011 and resulted in a gross margin reduction of three percentage points. Our wholesale gross profit and gross margins for the nine months ended August 31, 2011 were further impacted by our product placement mix with our wholesale customers.

Our retail gross profit increased to \$8,428,000 for the nine months ended August 31, 2011 from \$5,384,000 for the nine months ended August 31, 2010, a 57 percent increase, due primarily to a \$3,687,000 increase in retail sales. Our retail gross margin improved by approximately seven percentage point from the prior year comparative period due to less promotional activity. In the nine months ended August 31, 2010, we undertook a high level of promotional activity that negatively impacted our gross margins.

Selling, General and Administrative Expense, including Depreciation and Amortization and Retail Store Impairment

Selling, general and administrative, or SG&A, expenses increased to \$32,084,000 for the nine months ended August 31, 2011 from \$30,590,000 for the nine months ended August 31, 2010, a five percent increase. Our SG&A include expenses related to employee and employee related benefits, sales commissions, payments of the earn-out in connection with the merger with JD Holdings, advertising, sample production, facilities and distribution related costs, professional fees, stock-based compensation, factor and bank fees and also includes depreciation and amortization and retail store impairment. In the nine month ended August 31, 2011, we recorded a retail store impairment charge of \$1,144,000 related to the property and equipment at two of our full price retail stores. Based on the operating performance of these stores, we believed that we could not recover the carrying value of the property and equipment at these stores. Due to this impairment, our SG&A expenses increased correspondingly for the nine month ended August 31, 2011.

Our wholesale SG&A expense decreased to \$9,937,000 for the nine months ended August 31, 2011 from \$11,547,000 for the nine months ended August 31, 2010, a 14 percent decrease. Our wholesale SG&A expense was lower in the nine months ended August 31, 2011 mostly due to lower sample and distribution expenses. Cost savings in these areas resulted from close management of our sample expenses and consolidating our distribution function to our corporate facility.

Our retail SG&A expense increased to \$9,652,000 for the nine months ended August 31, 2011 from \$5,281,000 for the nine months ended August 31, 2010, an 83 percent increase. Our retail SG&A expense was impacted by the addition of costs associated with opening and operating seven additional stores between the end of the third quarter of fiscal 2010 and the end of our third quarter of fiscal 2011 and an impairment charge of \$1,144,000 related to the property and equipment at two of our full price retail stores.

Our corporate and other SG&A expense decreased to \$12,495,000 for the nine months ended August 31, 2011 from \$13,762,000 for the nine months ended August 31, 2010, a nine percent decrease. Our corporate and other SG&A expense includes general overhead associated with running our operations and decreased as we continue to monitor and manage the expenses associated with operating our business.

Operating Income

Our wholesale operating income decreased to \$13,285,000 for the nine months ended August 31, 2011 from \$17,738,000 for the nine months ended August 31, 2010, a 25 percent decrease. Our retail operating loss was \$1,224,000 for the nine months ended August 31, 2011 compared to operating income of \$103,000 for the nine months ended August 31, 2010. Our retail and overall operating losses were negatively impacted by a \$1,144,000 impairment charge related to the property and equipment at two of our full price retail stores. As a result, we had an operating loss of \$434,000 for the nine months ended August 31, 2011 compared to operating income of \$4,079,000 for the nine months ended August 31, 2010.

Table of Contents

Interest Expense

Our combined interest expense increased to \$365,000 for the nine months ended August 31, 2011 from \$329,000 for the nine months ended August 31, 2010, an 11 percent increase. Our interest expense consists of interest expense from our factoring and inventory lines of credit. This increase in interest expense is mostly due to higher average loan balances during the nine months ended August 31, 2011 under our factoring facility and inventory lines of credit.

Income Tax

Our effective tax rate was an expense of a negative 37 percent for the nine month period ended August 31, 2011 compared to an expense of 52 percent in the nine month period ended August 31, 2010. The decrease in the effective tax rate between the periods was primarily due to permanent tax deduction limitations related to executive compensation and the permanent book/tax difference associated with the costs of acquiring the trademark (in connection with the merger in 2007) remaining constant while the third quarter operating loss cause an operating loss for the nine month period ended August 31, 2011. The permanent book/tax difference resulted in taxable income with an associated tax expense despite the pre-tax operating loss. As a result, the use of an estimate annual effective tax rate cannot be relied upon and the actual effective year-to-date tax rate was used to calculate the income tax expense for the nine month period ended August 31, 2011.

Net Income

We had an operating loss of \$1,097,000 in the nine months ended August 31, 2011 compared to operating income \$1,784,000 for the nine months ended August 31, 2010. The shift from net income to net loss for the nine months ended August 31, 2010 compared to the nine months ended August 31, 2011 is largely the result of decreases in combined net sales and gross profit, which included the write down of \$1,620,000 to market value for finished goods inventory and an impairment charge of \$1,144,000 related to the property and equipment at two of our full price retail stores.

Liquidity and Capital Resources

Our primary sources of liquidity are: (i) cash from sales of our products; and (ii) sales from accounts receivable factoring facilities and advances against inventory. For the nine months ended August 31, 2011, we generated \$7,986,000 of cash flow from operations and used \$1,825,000 in investing activities for purchases of property and equipment mostly in connection with the opening and operation of our new and existing retail stores. We repaid \$411,000 in factored borrowings. We paid taxes on restricted stock units in the amount of \$519,000. Our cash balance increased to \$11,641,000 as of August 31, 2011.

We are dependent on credit arrangements with suppliers and factoring and inventory based agreements for working capital needs. From time to time, we have conducted equity financing through private placement transactions and obtained increases in our cash availability from CIT Commercial Services, a unit of CIT Group Inc., or CIT, through guarantees by certain related parties.

Our primary methods to obtain the cash necessary for operating needs were through the sales of Joe's® products, sales of our accounts receivable pursuant to our factoring agreements, obtaining advances under our inventory security agreements with CIT and utilizing existing cash balances. The accounts receivable are sold for up to 85 percent of the face amount on either a recourse or non-recourse basis depending on the creditworthiness of the customer. In addition, the inventory agreement allows us to obtain advances for up to 50 percent of the value of certain eligible inventory. CIT currently permits us to sell our accounts receivable at the maximum level of 85 percent and allows advances of up to \$6,000,000 for eligible inventory. CIT has the ability, in its discretion at any time or from time to time, to adjust or revise any limits on the amount of loans or advances made to us pursuant to these agreements and to impose surcharges on our rates for certain of our customers. As further assurance to CIT, cross guarantees were executed by and among us and all of our subsidiaries to guarantee each entity's obligations. As of August 31, 2011, our cash availability with CIT was approximately \$649,000. This amount fluctuates on a daily basis based upon invoicing and collection related activity by CIT on our behalf. In connection with both of the agreements with CIT, most of our tangible assets are pledged to CIT, including all inventory, merchandise, and/or goods, including raw materials through finished goods and receivables. Our trademarks are not encumbered.

Table of Contents

In May 2010, the parties amended the accounts receivable agreement to provide for a change in the factoring fees, an extension of the agreement and additional termination rights. The accounts receivable agreement may be terminated by CIT upon 60 days' written notice or immediately upon the occurrence of an event of default as defined in the agreement. The accounts receivable agreement may be terminated by us upon 60 days' written notice prior to June 30, 2012, or earlier provided that the minimum factoring fees have been paid for the respective period or CIT fails to fund us for five consecutive days. The inventory agreement may be terminated once all obligations are paid under both agreements or if an event of default occurs as defined in the agreement.

From June 1 to June 30, 2010, we paid to CIT a factoring rate of 0.6 percent to factor accounts which CIT bore the credit risk, subject to discretionary surcharges, and 0.4 percent for accounts which we bore the credit risk. The interest rate associated with borrowings under the inventory lines and factoring facility is 0.25 percent plus the Chase prime rate. Beginning July 1, 2010, the factoring rate changed to 0.55 percent for accounts which CIT bears the credit risk, subject to discretionary surcharges, up to \$40,000,000 of invoices factored, 0.50 percent over \$40,000,000 of invoices factored and 0.35 percent for accounts which we bear the credit risk as a result of the amended to the factoring agreements. As of August 31, 2011, the Chase prime rate was 3.25 percent.

We have also established a letter of credit facility with CIT to allow us to open letters of credit for a fee of 0.25 percent of the letter of credit face value with international and domestic suppliers, subject to cash availability on our inventory line of credit.

As of August 31, 2011, we had a net loan balance of \$11,262,000 with CIT for factored receivables, a loan balance of \$4,618,000 on inventory advances and no letters of credit outstanding.

For the remainder of fiscal 2011, our primary capital needs are for (i) operating expenses; (ii) working capital necessary to fund inventory purchases; (iii) capital expenditures to support additional retail store openings; (iv) financing extensions of trade credit to our customers; and (v) payment for the contingent consideration pursuant to the merger agreement with JD Holdings. We anticipate funding our operations through working capital generated by the following: (i) cash flow from sales of our products; (ii) managing our operating expenses and inventory levels; (iii) maximizing trade payables with our domestic and international suppliers; (iv) increasing collection efforts on existing accounts receivables; and (v) utilizing our receivable and inventory-based agreements with CIT.

Based on our cash on hand, cash flow from operations and the expected cash availability under both of our agreements with CIT, we believe that we have the working capital resources necessary to meet our projected operational needs for the remainder of fiscal 2011. However, if we require more capital for growth or experience operating losses, we believe that it will be necessary to obtain additional working capital through credit arrangements or debt or equity financings. We believe that any additional capital, to the extent needed, may be obtained from additional sales of equity securities or other loans or credit arrangements. There can be no assurance that this or other financings will be available if needed. Our inability to fulfill any interim working capital requirements would force us to constrict our operations.

We believe that the rate of inflation over the past few years has not had a significant adverse impact on our net sales or income (losses) from operations.

Off Balance Sheet Arrangements

We do not have any off balance sheet arrangements.

Management's Discussion of Critical Accounting Policies

We believe that the accounting policies discussed below are important to an understanding of our financial statements because they require management to exercise judgment and estimate the effects of uncertain matters in the preparation and reporting of financial results. Accordingly, we caution that these policies and the judgments and estimates

Table of Contents

they involve are subject to revision and adjustment in the future. While they involve less judgment, management believes that the other accounting policies discussed in Notes to Consolidated Financial Statements - Note 2 Summary of Significant Accounting Policies included in our Annual Report on Form 10-K for the year ended November 30, 2010 previously filed with the SEC are also important to an understanding of our financial statements. We believe that the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements.

Revenue Recognition

Wholesale revenues are recorded on the accrual basis of accounting when title transfers to the customer, which is typically at the shipping point. We record estimated reductions to revenue for customer programs, including co-op advertising, other advertising programs or allowances, based upon a percentage of sales. We also allow for returns based upon pre-approval or in the case of damaged goods. Such returns are estimated based on historical experience and an allowance is provided at the time of sale.

Retail store revenue is recognized net of estimated returns at the time of sale to consumers. E-commerce sales of products ordered through our retail internet site known as www.joesjeans.com are recognized upon estimated delivery and receipt of the shipment by the customers. E-commerce revenue is also reduced by an estimate of returns. Retail store revenue and E-commerce revenue exclude sales taxes. Revenue from licensing arrangements are calculated in accordance with the terms of the underlying agreements, generally based upon the higher of (a) contractually guaranteed minimum royalty levels; and (b) estimates of sales and royalty data received from our licensees. Payments received in consideration of the grant of a license or advanced royalty payments are recognized ratably as revenue over the term of the license agreement. The revenue recognized ratably over the term of the license agreement will not exceed royalty payments received. The unrecognized portion of the upfront payments are included in deferred royalties and accrued expenses depending on the long or short term nature of the payments to be recognized. As of August 31, 2011, we have recognized all of the advanced payments under our licensing agreements as income.

Accounts Receivable, Due To Factor and Allowance for Customer Credits and Doubtful Allowances

We evaluate our ability to collect on accounts receivable and charge-backs (disputes from the customer) based upon a combination of factors. Whether a receivable is past due is based on how recently payments have been received and in certain circumstances where we are aware of a specific customer's inability to meet its financial obligations (e.g., bankruptcy filings, substantial downgrading of credit sources). A specific reserve for bad debts is taken against amounts due to reduce the net recognized receivable to the amount reasonably expected to be collected. Amounts are charged off against the reserve once it is established that amounts are not likely to be collected. We recognize reserves for charge-backs based on our historical collection experience.

The balance in the allowance for customer credits and doubtful accounts as of August 31, 2011 and November 30, 2010 was \$952,000 and \$889,000, respectively, for non-factored accounts receivables.

Inventory

Edgar Filing: JOE'S JEANS INC. - Form 10-Q

We continually evaluate the composition of our inventories, assessing slow-turning, ongoing product as well as product from prior seasons. Market value of distressed inventory is valued based on historical sales trends on our individual product lines, the impact of market trends and economic conditions, and the value of current orders relating to the future sales of this type of inventory. Significant changes in market values could cause us to record additional inventory markdowns.

Table of Contents

Valuation of Long-lived and Intangible Assets and Goodwill

We assess the impairment of long-lived assets, identifiable intangibles and goodwill annually or whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors considered important that could trigger an impairment review other than on an annual basis include the following:

- A significant underperformance relative to expected historical or projected future operating results;
- A significant change in the manner of the use of the acquired asset or the strategy for the overall business; or
- A significant negative industry or economic trend.

When we determine that the carrying value of long-lived assets may not be recoverable based upon the existence of one or more of the aforementioned factors, impairment is measured based on a projected discounted cash flow method using a discount rate determined by management. These cash flows are calculated by netting future estimated sales against associated merchandise costs and other related expenses such as payroll, occupancy and marketing. For the third quarter of fiscal 2011, we recorded store impairment charges of \$1,144,000 related to two of our full price retail stores. Based on the operating performance of these stores, we believed that we could not recover the carrying value of property and equipment located at these stores.

In fiscal 2007, we acquired through merger JD Holdings, which included all of the goodwill and intangible assets goodwill related to the Joe s®, Joe s Jeans and JD® logo and marks. To date, we have not had to recognize any impairment related to the goodwill or intangible assets of our Joe s® brand. We have assigned an indefinite life to these intangible assets and therefore, no amortization expenses are expected to be recognized. However, we test the assets for impairment annually in accordance with our critical accounting policies.

Under the Financial Accounting Standards Board, or FASB, standards, we are required to evaluate goodwill and other indefinite lived intangible assets at least annually using a two-step process. The first step is to determine the fair value of each reporting unit and compare this value to its carrying value. If the fair value exceeds the carrying value, no further work is required and no impairment loss would be recognized. The second step is performed if the carrying value exceeds the fair value of the assets. The implied fair value of the reporting unit s goodwill or indefinite lived intangible assets must be determined and compared to the carrying value of the goodwill or indefinite lived intangible assets.

Our annual impairment testing date is September 30 of each year. For fiscal 2010, we determined that there was no impairment of our goodwill or indefinite lived intangible assets.

Additional Merger Consideration (Contingent Consideration)

Edgar Filing: JOE'S JEANS INC. - Form 10-Q

In connection with the merger with JD Holdings, we agreed to pay to Mr. Dahan the following contingent consideration in the applicable fiscal year for 120 months following October 25, 2007:

- No contingent consideration if the gross profit is less than \$11,250,000 in the applicable fiscal year;
- 11.33% of the gross profit from \$11,251,000 to \$22,500,000;
- 3% of the gross profit from \$22,501,000 to \$31,500,000;
- 2% of the gross profit from \$31,501,000 to \$40,500,000; and
- 1% of the gross profit above \$40,501,000.

The additional merger consideration, or contingent consideration, is paid in advance on a monthly basis based upon estimates of gross profits after the assumption that the payments are likely to be paid. At the end of each quarter, any overpayments are offset against future payments and any significant underpayments are made.

Under the FASB standards for accounting for consideration transferred to settle a contingency based on earnings or other performance measures, certain criteria is used to determine whether contingent consideration based on earnings or other performance measures should be accounted for as (1) adjustment of the purchase price of the acquired enterprise or (2) compensation for services, use of property or profit sharing. The determination of how to account for the contingent consideration is a matter of judgment that depends on the relevant facts and circumstances. The advanced contingent consideration payments are accounted for as operating expense.

Table of Contents

Income Taxes

As part of the process of preparing our consolidated financial statements, management is required to estimate income taxes in each of the jurisdictions in which we operate. The process involves estimating actual current tax expense along with assessing temporary differences resulting from differing treatment of items for book and tax purposes. These timing differences result in deferred tax assets and liabilities, which are included in our consolidated balance sheet. Management records a valuation allowance to reduce its deferred tax assets to the amount that is more likely than not to be realized. Management has considered future taxable income and ongoing tax planning strategies in assessing the need for the valuation allowance. Increases in the valuation allowance result in additional expense to be reflected within the tax provision in the consolidated statement of income. Reserves are also estimated for ongoing audits regarding federal and state issues that are currently unresolved. We routinely monitor the potential impact of these situations. Based on management's assessment of these items during fiscal 2009, we determined that it was more likely than not that the deferred tax assets would be fully utilized. Accordingly, the valuation allowance of \$20,291,000 as of November 30, 2008 was released and recorded as a credit to income tax benefit during fiscal 2009.

Contingencies

We account for contingencies in accordance with FASB standards that require we record an estimated loss from a loss contingency when information available prior to issuance of our financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the financial statements and the amount of the loss can be reasonably estimated. Accounting for contingencies such as legal and income tax matters requires management to use judgment. Many of these legal and tax contingencies can take years to be resolved. Generally, as the time period increases over which the uncertainties are resolved, the likelihood of changes to the estimate of the ultimate outcome increases. Management believes that the accruals for these matters are adequate. Should events or circumstances change, we could have to record additional accruals.

Stock Based Compensation

We account for stock-based compensation in accordance with the FASB standards. We elected the modified prospective method where prior periods are not revised for comparative purposes. Under the fair value recognition provisions, stock based compensation is measured at grant date based upon the fair value of the award and expense is recognized on a straight-line basis over the vesting period. We use the Black-Scholes option pricing model to determine the fair value of stock options, which requires management to use estimates and assumptions. The determination of the fair value of stock based option awards on the date of grant is based upon the exercise price as well as assumptions regarding subjective variables. These variables include our expected life of the option, expected stock price volatility over the term of the award, determination of a risk free interest rate and an estimated dividend yield. We estimate the expected life of the option by calculating the average term based upon historical experience. We estimate the expected stock price volatility by using implied volatility in market traded stock over the same period as the vesting period. We base the risk-free interest rate on zero coupon yields implied from U.S. Treasury issues with remaining terms similar to the term on the options. We do not expect to pay dividends in the foreseeable future and therefore use an expected dividend yield of zero. If factors change or we employ different assumptions for estimating fair value of the stock option, our estimates may be different than future estimates or actual values realized upon the exercise, expiration, early termination or forfeiture of those awards in the future. At this time, we believe that our current method for accounting for stock based compensation is reasonable. Furthermore, an entity may elect either an accelerated recognition method or a straight-line recognition method for awards subject to graded vesting based on a service condition, regardless of how the fair value of the award is measured. For all stock based compensation awards that contain graded vesting based on service conditions, we have elected to apply a straight-line recognition method to account for these awards. However, guidance is relatively new and the application of these principles over time may be subject to further interpretation or refinement. See Notes to Condensed Consolidated Financial Statements - Note 8 Stockholders' Equity Stock Incentive Plans for additional discussion.

Recent Accounting Pronouncements

There were no FASB issued standards that we adopted in the relevant periods.

Table of Contents

Item 3. Quantitative and Qualitative Disclosure About Market Risk.

We are exposed to certain market risks arising from transactions in the normal course of our business. Such risk is principally associated with interest rates and changes in our credit standing.

Interest Rate Risk

Our obligations under our receivable and inventory agreements with CIT bear interest at floating rates (primarily JP Morgan Chase prime rate). As a result, we are sensitive to changes in prevailing interest rates. We believe that a one percent increase or decrease in market interest rates that affect our financial instruments would have an immaterial impact on earnings or cash flow during the next fiscal year.

Foreign Currency Exchange Rates

Foreign currency exposures arise from transactions, including firm commitments and anticipated contracts, denominated in a currency other than an entity's functional currency and from foreign-denominated revenues translated into U.S. dollars. Changes in currency exchange rates may affect the relative prices at which we and our foreign competitors sell products in the same market and collect receivables from such sales. We generally sell our products in U.S. dollars. However, we sell a limited amount of our products to certain countries in Euros. We currently do not hedge our exposure to changes in foreign currency exchange rates as the amount of products sold would not be significantly impacted by rate fluctuations. We cannot assure you that foreign currency fluctuations will not have a material adverse impact on our financial condition and results of operations in the future.

We also source most of our products outside of the U.S. However, we generally purchase our products in U.S. dollars. The cost of these products may be affected by changes in the value of the relevant currencies; however, our exposure to currency exchange rates is limited as a result of such companies outside of the U.S. accepting payment in U.S. dollars.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

As of August 31, 2011, the end of the period covered by this periodic report, our management carried out an evaluation, with the participation of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15(b) and 15d-15(b) under the Exchange Act.

Edgar Filing: JOE'S JEANS INC. - Form 10-Q

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC rules and forms. In addition, disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that the information required to be disclosed by us in the reports we file or submit under the Exchange Act is accumulated and communicated to management, including our principal executive and principal financial officers or persons performing similar functions, as appropriate, to allow timely decisions regarding required disclosures. Management recognizes that a control system, no matter how well conceived and operated, can provide only reasonable assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues within the company have been detected. Therefore, assessing the costs and benefits of such controls and procedures necessarily involves the exercise of judgment by management. Our disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives.

As of the end of the period covered by this report, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective at the reasonable assurance level.

Changes in Internal Control Over Financial Reporting

We made no change in our internal control over financial reporting during the third quarter of the fiscal year covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II OTHER INFORMATION

Item 1. Legal Proceedings.

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

Item 1A. Risk Factors.

In addition to the other information set forth in this Quarterly Report, you should carefully consider the factors discussed under Risk Factors in our Annual Report on Form 10-K for the fiscal year ended November 30, 2010 as filed with the SEC. These risks could materially and adversely affect our business, financial condition and results of operations. The risks described in our Form 10-K are not the only risks we face. Our operations could also be affected by additional factors that are not presently known to us or by factors that we currently consider immaterial to our business.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

None.

Item 3. Defaults upon Senior Securities.

None.

Item 4. Removed and Reserved.

Item 5. Other Information.

(a) None.

(b) There have been no material changes to the procedures by which security holders may recommend nominees to our board of directors, including adoption of procedures by which our stockholders may recommend nominees to the our board of directors.

Table of Contents**Item 6. Exhibits.**

Exhibits (listed according to the number assigned in the table in Item 601 of Regulation S-K):

Exhibit No.	Description	Document if Incorporated by Reference
31.1	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as amended	Filed herewith
31.2	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as amended	Filed herewith
32	Certification of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Filed herewith
101.1*	The following materials from Joe's Jeans Inc.'s Quarterly Report on Form 10-Q for the quarter ended August 31, 2011, formatted in XBRL (eXtensible Business Reporting Language); (i) Condensed Consolidated Statements of Operations for the three and nine months ended August 31, 2011 and 2010, (ii) Condensed Consolidated Balance Sheets at August 31, 2011 and November 30, 2010, (iii) Condensed Consolidated Statements of Cash Flows for the nine months ended August 31, 2011 and 2010, and (iv) Notes to the Unaudited Condensed Consolidated Financial Statements.	Filed herewith

* Users of this data are advised pursuant to Rule 401 of Regulation S-T that the financial information contained in the XBRL-Related Documents is unaudited and, as a result, investors should not rely on the XBRL-Related Documents in making investment decisions. Furthermore, users of this data are advised in accordance with Rule 406T of Regulation S-T promulgated by the Securities and Exchange Commission that this Interactive Data File is deemed not filed or part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.

Table of Contents

SIGNATURES

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

JOE S JEANS INC.

October 11, 2011

/s/ Marc B. Crossman
Marc B. Crossman
Chief Executive Officer (Principal Executive Officer),
President and Director

October 11, 2011

/s/ Hamish Sandhu
Hamish Sandhu
Chief Financial Officer (Principal Financial Officer and
Principal Accounting Officer)

Table of Contents**EXHIBIT INDEX**

Exhibit No.	Description	Document if Incorporated by Reference
31.1	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as amended	Filed herewith
31.2	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as amended	Filed herewith
32	Certification of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Filed herewith
101.1*	The following materials from Joe's Jeans Inc.'s Quarterly Report on Form 10-Q for the quarter ended August 31, 2011, formatted in XBRL (eXtensible Business Reporting Language); (i) Condensed Consolidated Statements of Operations for the three and nine months ended August 31, 2011 and 2010, (ii) Condensed Consolidated Balance Sheets at August 31, 2011 and November 30, 2010, (iii) Condensed Consolidated Statements of Cash Flows for the nine months ended August 31, 2011 and 2010, and (iv) Notes to the Unaudited Condensed Consolidated Financial Statements.	Filed herewith

* Users of this data are advised pursuant to Rule 401 of Regulation S-T that the financial information contained in the XBRL-Related Documents is unaudited and, as a result, investors should not rely on the XBRL-Related Documents in making investment decisions. Furthermore, users of this data are advised in accordance with Rule 406T of Regulation S-T promulgated by the Securities and Exchange Commission that this Interactive Data File is deemed not filed or part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.