BLUEFLY INC
Form 10-Q
August 08, 2007

==========

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

FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2007

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

Commission File Number: 001-14498

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

Delaware	13-3612110
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
42 West 39th Street, New York, NY	10018
(Address of principal executive offices)	(Zip Code)

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

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

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

Large accelerated filer [ ] Accelerated filer [ ] Non-accelerated filer [X]

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

As of August 6, 2007, the issuer had outstanding 130,917,544 shares of Common Stock, $.01 par value.

==========

BLUEFLY, INC.
TABLE OF CONTENTS

Part I - FINANCIAL INFORMATION
Item 1. - FINANCIAL STATEMENTS

BLUEFLY, INC.

CONDENSED BALANCE SHEETS (Unaudited)

	JUNE 30, 2007
ASSETS	
Current assets	

Cash and cash equivalents	$ 14,626,00
Inventories, net	23,081,00
Accounts receivable, net of allowance for doubtful accounts	2,350,00
Prepaid inventory	569,00
Prepaid expenses	846,00
Other current assets	586,00
Total current assets	42,058,00
Property and equipment, net	4,939,00
Other assets	220,00
Total assets	$ 47,217,00
Current liabilities	
Accounts payable	$ 4,308,00
Allowance for sales returns	3,251,00
Accrued expenses and other current liabilities	1,324,00
Deferred revenue	2,532,00
Total current liabilities	11,415,00
Other long-term liabilities	131,00
Total liabilities	$ 11,546,00
Commitments and contingencies	
Shareholders' equity	
Series F Preferred stock - $.01 par value; 7,000 shares authorized, 571.43 issued and outstanding as of June 30, 2007 and December 31, 2006 (liquidation preference: $571,000 plus accrued dividends of $84,000, and $62,000 as of June 30, 2007 and December 31, 2006, respectively)	-
Common stock - $.01 par value; 200,000,000 and 152,000,000 shares authorized as of June 30, 2007 and December 31, 2006, respectively, 131,041,942 and 130,484,854, issued as of June 30, 2007 and December 31, 2006, respectively, 130,915,039 and 130,484,854 shares outstanding as of June 30, 2007 and December 31, 2006, respectively	1,309,00
Treasury Stock	(160,00
Additional paid-in capital	155,764,00
Accumulated deficit	(121,242,00
Total shareholders' equity	35,671,00
Total liabilities and shareholders' equity	$ 47,217,00

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

3

BLUEFLY, INC.
CONDENSED STATEMENTS OF OPERATIONS
(Unaudited)

SIX MONTHS ENDED

	JUNE 30,	
	2007	2006
Net sales	$ 43,716,000	$ 33,669,000
Cost of sales	26,879,000	19,784,000
Gross profit	16,837,000	13,885,000
Selling and fulfillment expenses	8,945,000	7,281,000
Marketing expenses	6,323,000	5,760,000
General and administrative expenses	7,040,000	5,650,000
Total operating expenses	22,308,000	18,691,000
Operating loss	(5,471,000)	(4,806,000
Interest income	364,000	112,000
Interest and other expense	(138,000)	(471,000
Net loss	$ (5,245,000)	$ (5,165,000
Preferred stock dividends	(22,000)	(2,221,000
Deemed dividends related to beneficial conversion feature on Series F Preferred Stock	--	(3,857,000
Net loss available to common shareholders	$ (5,267,000)	$ (11,243,000
Basic and diluted loss per common share	$ (0.04)	$ (0.37
Weighted average common shares outstanding (basic and diluted)	130,499,858	30,372,393

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

4

BLUEFLY, INC.
CONDENSED STATEMENTS OF OPERATIONS
(Unaudited)

	THREE MONTHS ENDED JUNE 30,	
	2007	2006
Net sales	$ 21,608,000	$ 16,793,000
Cost of sales	13,145,000	9,747,000
Gross profit	8,463,000	7,046,000

Selling and fulfillment expenses	4,546,000	3,848,000
Marketing expenses	2,712,000	1,729,000
General and administrative expenses	3,454,000	3,223,000
Total operating expenses	10,712,000	8,800,000
Operating loss	(2,249,000)	(1,754,000
Interest income	169,000	67,000
Interest and other expense	(62,000)	(214,000
Net loss	$ (2,142,000)	$ (1,901,000
Preferred stock dividends	(11,000)	(990,000
Deemed dividends related to beneficial conversion feature on Series F Preferred Stock	--	(3,857,000
Net loss available to common shareholders	$ (2,153,000)	$ (6,748,000
Basic and diluted loss per common share	$ (0.02)	$ (0.17
Weighted average common shares outstanding (basic and diluted)	130,508,897	40,267,334

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

CONDENSED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
YEAR ENDED DECEMBER 31, 2005, 2006 AND FOR THE SIX MONTHS ENDED
JUNE 30, 2007 (Unaudited)

	PREFERRED STOCK $.01 PAR VALUE		COMMON STOC $.01 PAR VAL	
	NUMBER OF SHARES	AMOUNT	NUMBER OF SHARES	
Balance at January 1, 2005	9,358,550	$ 94,000	15,241,756	$
Sale of Series F Preferred Stock ($1,000 per share net of expenses of $249,000)	7,000	--	--	
Shares Of Series D Preferred Stock Converted into Common Stock	(823)	$ --	1,454,645	
Shares Of Series F Preferred Stock Converted into Common Stock	(1,720)	$ --	765,481	
Expense recognized in connection with Issuance of Options	--	--	--	

Exercise of Employee Options	--	--	1,597,284	
Net Loss	--	--	--	
Balance at December 31, 2005	9,363,007	94,000	19,059,166	$
Conversion of Preferred Stock	(9,362,436)	(94,000)	48,545,527	
Stock based compensation	--	--	--	
Sale of Common Stock, net of issuance expenses of approximately $2.0 million	--	--	60,975,610	
Issuance of Common Stock to Placement Agent	--	--	1,000,000	
Warrants Issued to Third-Party	--	--	--	
Dividends Paid to Related Party Shareholders	--	--	--	
Deemed Dividends related to beneficial conversion on Series F Preferred Stock	--	--	--	
Exercise of Employee Options	--	--	43,330	
Issuance of Restricted Stock	--	--	861,221	
Net Loss	--	--	--	
Balance at December 31, 2006	571	$ --	130,484,854	$ 1
Stock based compensation	--	--	(12,173)	
Issuance of Restricted Stock	--	--	414,942	
Purchase of Treasury Stock	--	--	--	
Exercise of Employee Options	--	--	25,556	
Exercise of Related Party Warrant	--	--	1,860	
Net Loss	--	--	--	
Balance at June 30, 2007	571	$ --	130,915,039	$ 1

	ADDITIONAL PAID-IN CAPITAL	ACCUMULATED DEFICIT	TOTAL SHAREHOLD EQUITY
Balance at January 1, 2005	$ 107,270,000	$ (96,127,000)	$ 11,389
Sale of Series F Preferred Stock ($1,000 per share net of expenses of $249,000)	6,751,000	--	6,751
Shares Of Series D Preferred Stock Converted into Common Stock	(15,000)	--	
Shares Of Series F Preferred Stock Converted into Common Stock	(8,000)	--	

Expense recognized in connection with Issuance of Options	41,000	--	41
Exercise of Employee Options	1,488,000	--	1,504
Net Loss	--	(3,820,000)	(3,820
Balance at December 31, 2005	$ 115,527,000	$ (99,947,000)	$ 15,865
Conversion of Preferred Stock	(391,000)	--	
Stock based compensation	4,454,000	--	4,454
Sale of Common Stock, net of issuance expenses of approximately $2.0 million	47,420,000	--	48,030
Issuance of Common Stock to Placement Agent	1,070,000	--	1,080
Warrants Issued to Third-Party	67,000	--	67
Dividends Paid to Related Party Shareholders	(19,512,000)	--	(19,512
Deemed Dividends related to beneficial conversion on Series F Preferred Stock	3,857,000	(3,857,000)	
Exercise of Employee Options	36,000	--	36
Issuance of Restricted Stock	(9,000)	--	
Net Loss	--	(12,193,000)	(12,193
Balance at December 31, 2006	$ 152,519,000	$ (115,997,000)	$ 37,827
Stock based compensation	3,227,000	--	3,227
Issuance of Restricted Stock	(4,000)	--	
Purchase of Treasury Stock	--	--	(160
Exercise of Employee Options	22,000	--	22
Exercise of Related Party Warrant	--	--	
Net Loss	--	(5,245,000)	(5,245
Balance at June 30, 2007	$ 155,764,000	$ (121,242,000)	$ 35,671

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

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

SIX MONTHS ENDED

	JUNE 30,	
	2007	2006
Cash flows from operating activities		
Net loss	$ (5,245,000)	$ (5,165,000)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	836,000	729,000
Stock based compensation	3,227,000	1,223,000
Warrant issued to consultant	--	67,000
Provisions for returns	(1,791,000)	(482,000)
Bad debt expense	298,000	448,000
Reserve for inventory obsolescence	402,000	615,000
Warrant issued to supplier	--	133,000
Changes in operating assets and liabilities:		
(Increase) decrease in		
Inventories	706,000	(4,985,000)
Accounts receivable	71,000	(850,000)
Prepaid expenses	(458,000)	321,000
Other current assets	(193,000)	(109,000)
Increase (decrease) in		
Accounts payable	(383,000)	(2,131,000)
Accrued expenses	(411,000)	1,641,000
Interest payable to related party shareholders	--	271,000
Deferred revenue	(298,000)	480,000
Net cash (used in) provided by operating activities	(3,239,000)	(7,794,000)
Cash flows from investing activities		
Purchase of property and equipment	(2,171,000)	(592,000)
Net cash (used in) provided by investing activities	(2,171,000)	(592,000)
Cash flows from financing activities		
Payments of capital lease obligation	(14,000)	(27,000)
Net proceeds from exercise of stock options	22,000	--
Purchase of Treasury Stock	(160,000)	--
Net proceeds from June 2006 Financing	--	48,002,000
Repayment of related party Notes Payable and interest	--	(5,488,000)
Dividends paid to related party shareholders	--	(19,512,000)
Net cash (used in) provided by financing activities	(152,000)	22,975,000
Net (decrease) increase in cash and cash equivalents	(5,562,000)	14,589,000
Cash and cash equivalents - beginning of period	20,188,000	9,408,000
Cash and cash equivalents - end of period	$ 14,626,000	$ 23,997,000
Supplemental schedule of non-cash investing and financing activities:		
Cash paid for interest	$ 61,000	$ 92,000
Cash paid for interest - to related shareholder	--	$ 1,488,000
Warrant issued to consultant	--	$ 67,000
Deemed dividend related to beneficial conversion		

feature on Series F Preferred Stock	--	$ 3,857,000

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

7

BLUEFLY, INC.
JUNE 30, 2007

NOTE 1 - BASIS OF PRESENTATION

The accompanying financial statements include the accounts of Bluefly, Inc. (the "Company"). The financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnote disclosures required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting mainly of normal recurring accruals) considered necessary for a fair statement have been included. The results of operations of any interim period are not necessarily indicative of the results of operations to be expected for the fiscal year due to seasonal and other factors. For further information, refer to the financial statements and accompanying footnotes included in the Company's Form 10-K for the year ended December 31, 2006.

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

NOTE 2 - THE COMPANY

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

NOTE 3 - OFFER TO EXCHANGE

In January 2007, the Company commenced an exchange offer (the "Exchange Offer") pursuant to which it offered eligible employees and non-employee directors the opportunity to exchange, on a grant-by-grant basis: (a) their outstanding eligible stock options that were vested as of August 31, 2006 for restricted stock awards consisting of the right to receive restricted common stock of the Company (the "Restricted Stock Awards"); and (b) their outstanding eligible stock options that were not vested as of August 31, 2006 for deferred restricted stock unit awards consisting of rights to receive common stock of the Company on specified dates subsequent to vesting (the "Deferred Stock Unit Awards," and, together with the Restricted Stock Awards, the "Replacement Awards").

In order to be eligible to participate in the Exchange Offer, an option holder was required to (a) have been an employee or non-employee director of the Company on the date of the Exchange Offer, (b) have neither ceased to be an employee or non-employee director, nor have submitted or received a notice of

termination of employment or resignation, prior to the expiration of the Exchange Offer and (c) owned eligible options. Options eligible for exchange in the Exchange Offer were outstanding options granted under the Company's three stock based employee compensation plans (collectively the "Plans") that, in each case, had an exercise price per share that was greater than $1.50.

The number of Replacement Awards an eligible participant was eligible to receive in exchange for an eligible option was determined by a specific exchange ratio applicable to that option, as set forth in the Offer to Exchange included as an exhibit to the Schedule TO filed by the Company with the Securities and Exchange Commission in connection with the Exchange Offer (the "Offer to Exchange").

Restricted Stock Awards granted pursuant to the Exchange Offer vest and become free from restriction one year from the date of the exchange, except if the grantee made an election under Section 83(b) of the Internal Revenue Code of 1986, as amended, in which case the restrictions on such Restricted Stock Award lapsed only with respect to the number of shares needed to satisfy any applicable tax withholding as of the date that the Company received such election, as more fully described in the Offer to Exchange. The minimum period for full vesting of Deferred Stock Unit Awards is two years from the date of exchange. The length of the vesting schedule applicable to each Deferred Stock Unit Award was based on the final vesting date of the eligible stock option as follows:

DEFERRED STOCK UNIT AWARDS VESTING SCHEDULE

FINAL VESTING DATE OF ELIGIBLE STOCK OPTION AS OF DATE OF CANCELLATION	TOTAL VESTING PERIOD OF DEFERRED STOCK UNIT AWARDS	PERCENTAGE OF DEFERRED STOCK UNIT AWARDS VESTED QUARTERLY*
Prior to August 31, 2007	2 years	12 1/2%
On or after August 31, 2007	3 years	8 1/3%

*Deferred Stock Unit Awards vest in substantially equal quarterly installments over the applicable vesting period, subject to the participant's continued employment with (or service on the Board of Directors of) the Company.

The shares of common stock underlying the Deferred Stock Unit Award will be delivered on the Delivery Date. The Delivery Date is the date on which the earliest of the following occurs:

DELIVERY DATE

- 2 years from the date of grant (with respect to Deferred Stock Units Awards exchanged for eligible stock options with a vesting date prior to August 31, 2007)

  OR

  3 years from the date of grant (with respect to Deferred Stock Units Awards exchanged for eligible stock options with a vesting date on or after August 31, 2007)

- Death

- The date on which the employee becomes disabled

Melissa Payner-Gregor, the Company's chief executive officer, and Patrick C. Barry, the Company's chief financial officer, were not eligible to participate in the Exchange Offer, but previously participated in an exchange in November 2006 through each of their employment agreements, which is described in the Offer to Exchange.

Pursuant to the Exchange Offer, options to purchase an aggregate of 1,562,000 shares of Common Stock were exchanged in return for an aggregate of 472,471 Restricted Stock Awards and an aggregate of 394,405 Deferred Stock Unit Awards. In connection with the Exchange Offer, the Company will recognize $916,000 of expense over the next three years. For the six months ended June 30, 2007 approximately $301,000 of this amount has been expensed.

NOTE 4 - FINANCING AGREEMENT

The Company has a three year revolving credit facility (the "Credit Facility") with Wells Fargo Retail Finance, LLC ("Wells Fargo"). Under the terms of the Credit Facility, Wells Fargo provides the Company with a revolving credit facility and issues letters of credit in favor of suppliers or factors. The Credit Facility is secured by a lien on substantially all of the Company's assets. Historically, the Credit Facility had also been secured by a $2,000,000 letter of credit issued by an affiliate of Soros Fund Management LLC ("Soros") in favor of Wells Fargo (the "Soros LC"). In August 2006, Wells Fargo agreed to release the Soros LC, and that it would no longer require an availability reserve (although it has the right under the Credit Facility to establish reserves in the future, as it deems appropriate). In return, the Company agreed to maintain a minimum cash balance of $5,000,000. Availability under the Credit Facility is determined by a formula that takes into account the amount of the Company's inventory and accounts receivable. The maximum availability is currently $7,500,000, but can be increased to $12,500,000 at the Company's request, subject to certain conditions. As of June 30, 2007, total availability under the Credit Facility was approximately $6,800,000, of which $3,200,000 was committed, leaving approximately $3,600,000 available for further borrowings.

Interest accrues monthly on the average daily amount outstanding under the Credit Facility during the preceding month at a per annum rate equal to the prime rate plus 0.75% or LIBOR plus 2.75%. The Company also pays a monthly commitment fee on the unused portion of the facility (i.e., $7,500,000 less the amount of loans outstanding) equal to 0.35%. The Company also pays Wells Fargo certain fees to open letters of credit and guarantees in an amount equal to a certain percentage of the face amount of the letter of credit for each thirty (30) days such letter of credit, or a portion thereof, remains open. For the six months ended June 30, 2007 and 2006, the Company incurred approximately $61,000 and $ 92,000, respectively, in connection with these fees.

NOTE 5 - LOSS PER SHARE

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

Diluted loss per share is computed by dividing loss available to common shareholders by the weighted average number of common shares outstanding for the period, adjusted to reflect potentially dilutive securities. Due to the loss from continuing operations, the following (i) options and warrants to purchase shares of Common Stock, (ii) Preferred Stock convertible into shares of Common Stock, (iii) Restricted Stock Awards that have not yet vested and (iv) Deferred Stock Unit Awards ("DSUs") for shares that have not yet been delivered were not included in the computation of diluted loss per share because the result of the exercise of such inclusion would be antidilutive:

Security	June 30, 2007	Exercise Prices	June 30, 2006	Exercise Pric
Options	3,541,908	$0.80 - $14.38	8,103,028	$0.69 - $16.
Restricted Stock Awards/DSUs	10,800,688 (2)	--	--	
Warrants	1,214,249	$0.78 - $3.96	1,945,893	$0.78 - $ 3.
Preferred Stock	696,341 (1)	--	--	

(1) At June 30, 2007, there were 571 shares of Series F Convertible Preferred Stock outstanding that are convertible into approximately 696,341 shares of Common Stock (excluding dividends).

(2) Includes both Restricted Stock Awards and DSUs.

NOTE 6 - STOCK BASED COMPENSATION

The Company accounts for stock based compensation in accordance with the provisions of Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment" ("SFAS No. 123(R)"), which requires that the costs resulting from all share-based payment transactions be recognized in the financial statements at their fair values. Effective January 1, 2006 the Company adopted SFAS No. 123(R) using the modified prospective application method under which the provisions of SFAS No. 123(R) apply to new awards and to awards modified, repurchased, or cancelled after the adoption date. Additionally, compensation cost for the portion of the awards for which the requisite service has not been rendered that are outstanding as of the adoption date is recognized in the Statement of Operations over the remaining service period after the adoption date based on the award's original estimate of fair value. Results for prior periods have not been restated. Total share-based compensation expense recorded in the Statement of Operations for the six months ended June 30, 2007 was $3,227,000, compared to $1,223,000 for the six months ended June 30, 2006.

STOCK OPTIONS

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

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

BLUEFLY, INC.
JUNE 30, 2007

	NUMBER OF SHARES	WEIGHTED AVERAGE EXERCISE PRICE
Balance at December 31, 2006	5,417,116	$ 1.68
Options granted	30,000	$ 1.05
Options canceled	(1,879,652)	$ 2.87
Options exercised	(25,556)	$ 0.89
Balance at June 30, 2007	3,541,908	$ 1.06
Vested at December 31, 2006	3,682,877	$ 1.83
Vested at June 30, 2007	2,672,684	$ 1.03

During the second quarter of 2007, 311,063 options vested. Of these options 220,900 were canceled or expired. The total fair value of the options vested (including those canceled) during the quarter ended June 30, 2007 was approximately $292,000. During the quarter, 30,000 options were granted. At June 30, 2007, the aggregate intrinsic value of the fully vested options was $131,000 and the weighted average remaining contractual life of the options was 6.2 years. The Company has not capitalized any compensation cost, or modified any of its stock option grants during the first half of 2007, except for those described in connection with the Offer to Exchange. Approximately 18,056 options with an intrinsic value of approximately $3,600 were exercised during the second quarter of 2007. No cash was used to settle equity instruments granted under the Plans during the second quarter of 2007.

As of June 30, 2007, the total compensation cost related to non-vested awards not yet recognized was $699,000. Total compensation cost is expected to be recognized over 2 years on a weighted average basis.

RESTRICTED STOCK AWARDS AND DEFERRED STOCK UNIT AWARDS

The following table is a summary of activity related to Restricted Stock Awards and Deferred Stock Unit Awards for employees at June 30, 2007:

	RESTRICTED STOCK AWARDS	DEFERRED STOCK UNIT AWARDS
Balance at January 1, 2007	861,221	9,862,267
Shares/Units Granted	414,942	544,405
Shares/Units Forfeited	(12,173)	(8,753)
Shares/Units Restriction Lapses	861,221	--
Balance at June 30, 2007	402,769	10,397,919
Weighted Average Grant Date Fair Value Per share	$ 1.27	$ 0.95
Aggregate Grant Date Fair Value	$ 511,517	$ 9,878,023
Vesting Service Period of Shares Granted	12 months	12-36 months
Number of shares/units vested at June 30, 2007	--	--
Number of shares/units unvested at June 30, 2007	402,769	10,397,919

For the quarter ended June 30, 2007, the Company recognized an expense of approximately $1.4 million in connection with these awards.

As of June 30, 2007, the total compensation cost related to non-vested restricted stock and deferred stock units not yet recognized was $8.9 million. Total compensation cost is expected to be recognized over a two year period.

BLUEFLY, INC.
JUNE 30, 2007

NOTE 7 - NEW ACCOUNTING PRONOUNCEMENTS

In July 2006, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes--an interpretation of FASB Statement No. 109" ("FIN 48"), which clarifies the accounting for uncertainty in tax positions. This Interpretation requires an entity to recognize the impact of a tax position in its financial statements if that position is more likely than not to be sustained on audit based on the technical merits of the position. The provisions of FIN 48 are effective as of the beginning of fiscal year 2007, with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings.

The implementation of FIN 48 had no impact on the Company's financial statement as the Company has no uncertain tax positions. The Company is primarily subject to US federal and New York State income tax. Tax years subsequent to 2004 remain open to review by US federal and state tax authorities.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW

Bluefly, Inc. is a leading Internet retailer that sells over 350 brands of designer apparel, accessories and home furnishings at discounts of up to 75% off of retail value. We launched our Web site in September 1998. Over the past five years, our sales have grown at a compounded annual growth rate of approximately 30%. During that same time, our gross margin levels have increased from a range between 21.3% and 38.6% during 2003 to a range between 37.4% and 42.0% during 2006 and 2007.

The increase in our margin and sales over the past few years is the direct result of the merchandise strategy that we began to implement in spring 2004. As part of that strategy, we are bringing the latest fashion trends to our customer for great value and more current season merchandise. While there will be some fluctuation in our gross margin percentage from quarter to quarter as we further develop our merchandising and marketing strategy (for example, our gross margin percentage decreased for the second quarter of 2007 as compared to the second quarter of 2006), we believe that we will be able to maintain margins in the 38% to 40% range.

We believe that there is an opportunity to accelerate the growth of our business while continuing to provide our customers with the great values that they have become accustomed to. In an effort to take advantage of this opportunity, we have invested much more aggressively in marketing during the past 21 months.

Our net sales increased by approximately 29% to $21,608,000 for the three months ended June 30, 2007 from $16,793,000 for the three months ended June 30, 2006. Our gross margin decreased to 39.2% for the three months ended June 30, 2007 from 42.0% for the three months ended June 30, 2006. Our gross profit increased by approximately 20% to $8,463,000 for the three months ended June 30, 2007 from $7,046,000 for the three months ended June 30, 2006. Our operating loss

increased to $2,249,000 for the three months ended June 30, 2007 from $1,754,000 for the three months ended June 30, 2006. This increase was primarily a result of an increase in stock-based compensation as a result of equity awards granted in the fourth quarter of 2006 as well as incremental expense recorded in accordance with SFAS No. 123(R) in connection with the Offer to Exchange. Increased marketing expenses (excluding staff related costs) of $2,389,000 for the second quarter of 2007 from $1,309,000 for the second quarter 2006 also contributed to the increase in the operating loss.

Our reserve for returns and credit card chargebacks increased to 42.1% of gross sales for the second quarter of 2007 compared to 41.8% for the second quarter of 2006. The increase was primarily caused by a shift in our merchandise mix towards higher end products. However, we believe that this increase in return rates has been more than offset by the higher gross margin dollars and average order sizes that have been generated by this shift in our merchandise mix. In addition, gross margin dollars per order continues to increase.

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

At June 30, 2007, we had an accumulated deficit of $121,242,000. The net losses and accumulated deficit resulted primarily from the costs associated with developing and marketing our Web site and building our infrastructure, as well as non-cash beneficial conversion charges resulting from decreases in the conversion price of our Preferred Stock and the payment of dividends to holders of Preferred Stock. In order to expand our business, we intend to invest in sales, marketing,

merchandising, operations, information systems, site development and additional personnel to support these activities. Therefore, we may continue to incur substantial operating losses. Although we have experienced revenue growth in recent years, this growth may not be sustainable and therefore should not be considered indicative of future performance.

RESULTS OF OPERATIONS

FOR THE SIX MONTHS ENDED JUNE 30, 2007 COMPARED TO THE SIX MONTHS ENDED JUNE 30, 2006

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

	2007		2006		
		As a % of Net Sales		As a % of Net Sales	
Net sales	$ 43,716	100.0%	$ 33,669	100.0%	$
Cost of sales	26,879	61.5%	19,784	58.8%	

Gross profit	16,837	38.5%	13,885	41.2%
Selling and fulfillment expenses	8,945	20.4%	7,281	21.6%
Marketing expenses	6,323	14.5%	5,760	17.1%
General and administrative expenses	7,040	16.1%	5,650	16.8%
Total operating expenses	22,308	51.0%	18,691	55.5%
Operating loss	(5,471)	(12.5)%	(4,806)	(14.3)%
Interest (expense) and other income	226	0.5%	(359)	(1.1)%
Net loss	(5,245)	(12.0)%	(5,165)	(15.4)%

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

	2007	2006	2005
Average Order Size (including shipping & handling)	$ 276.49	$ 246.13	$ 207.54
New Customers Added during the Period	94,487	76,487	66,326

NET SALES: Gross sales for the six months ended June 30, 2007 increased by approximately 31% to $73,694,000 from $56,117,000 for the six months ended June 30, 2006. For the six months ended June 30, 2007, we recorded a provision for returns and credit card chargebacks and other discounts of $29,978,000, or approximately 41% of gross sales. For the six months ended June 30, 2006, the provision for returns and credit card chargebacks and other discounts was $22,448,000, or approximately 40% of gross sales. The increase in this provision as a percentage of gross sales resulted from an increase in the return rate. The increase in return rate was primarily caused by an increase in average order size as well as a shift in our merchandise mix towards higher end products. However, we believe that this increase in return rates has been more than offset by the higher gross profit and average order sizes that have been generated by this shift in merchandise mix. Gross margin dollars per order continue to increase, growing to $64.68 for the six months ended June 30, 2007 from $61.92 for the six months ended June 30, 2006.

After the necessary provisions for returns, credit card chargebacks and adjustments for uncollected sales taxes, our net sales for the six months ended June 30, 2007 were $43,716,000. This represents an increase of approximately 29.8% compared to the six months ended June 30, 2006, in which net sales totaled $33,669,000. The growth in net sales resulted from both an increase in the number of new customers acquired (approximately 24% higher compared to the first half 2006) and an increase in average order size (over 12% higher compared to the first half 2006). For the six months ended June 30, 2007 revenue from shipping and handling (which is included in net sales) increased approximately 21% in 2007 to $2,391,000 from $1,970,000 in 2006.

COST OF SALES: Cost of sales consists of the cost of product sold to customers,

in-bound and out-bound shipping costs, inventory reserves, commissions and packing materials. Cost of sales for the six months ended June 30, 2007 totaled $26,879,000, resulting in gross margin of approximately 38.5%. Cost of sales for the six months ended June 30, 2006 totaled $19,784,000, resulting in gross margin of 41.2%. Gross profit increased by 21%, to $16,837,000 for the six months ended June 30, 2007 compared to $13,885,000 for the six months ended June 30, 2006. The growth in gross profit was the result of increased sales. The growth in the high-end designer business has a significant impact on the overall mix of the business which continues to negatively impact the gross margin percentage. The combination of the high demand for this merchandise and the decline of the dollar versus the Euro had a negative impact on the designer accessory and shoe gross margins, however the gross margin dollars per order continue to grow.

MARKETING EXPENSES: Marketing expenses increased by approximately 10% to $6,323,000 for the six months ended June 30, 2007 compared to $5,760,000 for the six months ended June 30, 2006. While net sales for the six months increased by almost 30%, our marketing expenses as a percentage of net sales decreased to 14.5% for the six months ended June 30, 2007 from 17.1% for the six months ended June 30, 2006.

Marketing expenses include expenses related to paid search, online and print advertising, television, fees to marketing affiliates, direct mail campaigns as well as staff related costs. Total expenses related to the national print and television advertising campaign for the six months ended June 30, 2007 totaled $2.8 million compared to $3.1 million for the six months ended June 30, 2006. The increase in marketing expenses was attributable to an increase in online marketing expenses including affiliates, email and sweepstakes. These increases were partially offset by a decrease of $332,000 in connection with costs associated with our national advertising campaign.

SELLING AND FULFILLMENT EXPENSES: Selling and fulfillment expenses increased by approximately 23% in the first six months of 2007 compared to the first six months of 2006. Selling and fulfillment expenses were comprised of the following:

	Six Months Ended June 30, 2007	As a % of Net Sales	Six Months Ended June 30, 2006	As a % of Net Sales	Percentage Diff increase (decr
Operating	4,732,000	10.8%	3,699,000	11.0%	28%
Technology	2,399,000	5.5%	1,989,000	5.9%	21%
E-Commerce	1,814,000	4.2%	1,593,000	4.7%	14%
	$ 8,945,000	20.5%	$ 7,281,000	21.6%	23%

As a percentage of net sales, our selling and fulfillment expenses decreased to 20.5% for the six months ended June 30, 2007 from 21.6% for the six months ended June 30, 2006.

Operating expenses include all costs related to inventory management, fulfillment, customer service, and credit card processing. Operating expenses increased in the first six months of 2007 by approximately 28% compared to the first six months of 2006 as a result of variable costs associated with the increased sales volume (e.g., picking and packing orders, processing returns and credit card fees) and an increase in salary related expenses, as well as incremental one time costs of approximately $170,000 incurred in connection with our move to a new third party fulfillment center. Included in operating expenses for 2006, was a refund from one of our credit card processors due to the fact

that it had charged us at incorrect rates during previous periods.

Technology expenses consist primarily of staff related costs, amortization of capitalized costs and Web site hosting. For the six months ended June 30, 2007, technology expenses increased by approximately 21% compared to the six months ended June 30, 2006. This increase resulted from an increase in salary related expenses, as well as an increase in software support, web hosting and training. This increase was partially offset by a decrease in consulting expenses as most of the consulting expenses incurred in the first half of 2007 were related to the development of our new Web site and capitalized accordingly. For the first six months of 2007 approximately $1,219,000 was capitalized in connection with the development of our new Web site.

E-Commerce expenses include expenses related to our photo studio, image processing, and Web site design. For the six months ended June 30, 2007, e-commerce expenses increased by approximately 14% as compared to the six months ended June 30, 2006, primarily due to an increase in salary related expenses as well as an increase in expenses associated with photo shoots. In

addition, for the six months ended June 30, 2007, equity based compensation increased compared to the six months ended June 30, 2006, as a result of the Exchange Offer and new equity awards.

GENERAL AND ADMINISTRATIVE EXPENSES: General and administrative expenses include merchandising, finance and administrative salaries and related expenses, insurance costs, accounting and legal fees, depreciation and other office related expenses. General and administrative expenses for the six months ended June 30, 2007 increased by approximately 25% to $7,040,000 as compared to $5,650,000 for the six months ended June 30, 2006. The increase in general and administrative expenses was primarily the result of the recording of $2,844,000 of expense related to employee stock options in the six month period and increased consulting and professional fees of $141,000. These increases were partially offset by a decrease in salary and salary related expenses of $291,000 and a decrease in public company expenses of $142,000.

As a percentage of net sales, general and administrative expenses for the first half of 2007 decreased slightly to 16.1% from 16.8% for the first half of 2006.

LOSS FROM OPERATIONS: Operating loss increased by approximately 14% in the first six months of 2007 to $5,471,000 from $4,806,000 in the first six months of 2006, as the increase in net sales and gross margin were more than offset by the incremental marketing expenses and an increase in expenses related to employee stock options.

INTEREST INCOME: Other income for the six months ended June 30, 2007 increased to $364,000 from $112,000 for the six months ended June 30, 2006. These amounts relate primarily to interest income earned on our cash balances.

INTEREST AND OTHER EXPENSE: Interest expense for the six months ended June 30, 2007 totaled $138,000, compared to $471,000 for the six months ended June 30, 2006. Interest expense relates to fees paid in connection with our Credit Facility, as well as interest expense on the Notes that were repaid in June 2006.

FOR THE THREE MONTHS ENDED JUNE 30, 2007 COMPARED TO THE THREE MONTHS ENDED JUNE 30, 2006.

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

	2007		2006	
		As a % of Net Sales		As a % of Net Sales
Net sales	$ 21,608	100.0%	$ 16,793	100.0%
Cost of sales	13,145	60.8%	9,747	58.0%
Gross profit	8,463	39.2%	7,046	42.0%
Selling and fulfillment expenses	4,546	21.0%	3,848	22.9%
Marketing expenses	2,712	12.6%	1,729	10.3%
General and administrative expenses	3,454	16.0%	3,223	19.2%
Total operating expenses	10,712	49.6%	8,800	52.4%
Operating loss	(2,249)	(10.4)%	(1,754)	(10.4)%
Interest (expense) and other income	107	0.5%	(147)	(0.9)%
Net loss	(2,142)	(9.9)%	(1,901)	(11.3)%

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

	2007	2006	2005
Average Order Size (including shipping & handling)	$ 284.01	$ 248.32	$ 216.09
New Customers Added during the Period	45,102	37,779	29,561

15

BLUEFLY, INC.
JUNE 30, 2007

NET SALES: Gross sales for the three months ended June 30, 2007 increased by 29% to $37,327,000 from $28,872,000 for the three months ended June 30, 2006. For the three months ended June 30, 2007, we recorded a provision for returns and credit card chargebacks and other discounts of $15,719,000, or approximately 42.1% of gross sales. For the three months ended June 30, 2006, the provision for returns and credit card chargebacks and other discounts was $12,079,000, or approximately 41.8% of gross sales. The increase in the return rate in this provision as a percentage of gross sales resulted from an increase in the return rate. The increase was primarily caused by a shift in our merchandise mix towards higher end products. However, we believe that this increase in return rates has been more than offset by the higher gross margins and average order sizes that have been generated by this shift in merchandise mix. Gross margin dollars per order continue to increase, growing to $66.53 for the three months ended June 30, 2007 from $61.85 for the three months ended June 30, 2006

After the necessary provisions for returns, credit card chargebacks and adjustments for uncollected sales taxes, our net sales for the three months ended June 30, 2007 were $21,608,000. This represents an increase of approximately 29% compared to the three months ended June 30, 2006, in which net sales totaled $16,793,000. The growth in net sales resulted from both an increase in the number of new customers acquired (over 19% higher compared to the three months ended June 30, 2006) and an increase in average order size (over 14% higher compared to the three months ended June 30, 2006). For the three months ended June 30, 2007, revenue from shipping and handling (which is included in net sales) increased approximately 18% to $1,190,000 from $1,005,000 for the three months ended June 30, 2006.

COST OF SALES: Cost of sales for the three months ended June 30, 2007 totaled $13,145,000, resulting in gross margin of approximately 39.2%. Cost of sales for the three months ended June 30, 2006 totaled $9,747,000, resulting in gross margin of 42.0%. Gross profit increased by approximately 20%, to $8,463,000 for the three months ended June 30, 2007 compared to $7,046,000 for the three months ended June 30, 2006. The growth in gross profit was the result of increased average order size and growth in sales. The growth in the high-end designer business has a significant impact on the overall mix of the business which continues to negatively impact the gross margin percentage. The combination of the high demand for this merchandise and the decline of the dollar versus the Euro had a negative impact on the designer accessory and shoe gross margins. however the gross margin dollars per order continue to grow.

MARKETING EXPENSES: Marketing expenses increased by 57% to $2,712,000 for the three months ended June 30, 2007 from $1,729,000 for the three months ended June 30, 2006. As a percentage of net sales, our marketing expenses increased to 12.6% for the three months ended June 30, 2007 from 10.3% for the three months ended June 30, 2006. Some of the increase in the period is due to the timing of the launch of national campaign between the first and second quarter of 2007.

Total expenses related to the national print and television advertising campaign for the three months ended June 30, 2007 totaled $929,000 compared to $279,000 for the three months ended June 30, 2006. The increase in marketing was attributable to an increase of $650,000 in connection with costs associated with our national ad campaign, as well as increases related to paid search, affiliates, sweepstakes and email.

SELLING AND FULFILLMENT EXPENSES: Selling and fulfillment expenses increased by 18% for the three months ended June 30, 2007 compared to the three months offended June 30, 2006. Selling and fulfillment expenses were comprised of the following:

	Three Months Ended June 30, 2007	As a % of Net Sales	Three Months Ended June 30, 2006	As a % of Net Sales	Percentage Diff increase (decr
Operating	2,467,000	11.4%	1,949,000	11.6%	27%
Technology	1,231,000	5.7%	1,017,000	6.0%	21%
E-Commerce	848,000	3.9%	882,000	5.3%	(4)%
	$ 4,546,000	21.0%	$ 3,848,000	22.9%	18%

As a percentage of net sales, our selling and fulfillment expenses decreased to 21% for the three months ended June 30, 2007 from approximately 23% for the three months ended June 30, 2006.

Operating expenses increased in the three months ended June 30, 2007 by approximately 27% compared to the three months ended June 30, 2006 as a result of variable costs associated with the increased sales volume (e.g., picking and packing orders

and processing returns) and an increase in customer service and salary related expenses. In addition, during the quarter we started to move to a new third party fulfillment center and incurred an incremental one time expense of approximately $170,000. Start-up issues associated with the transition to the new fulfillment center resulted in certain cancelled orders and associated expenses during July 2007. We expect to incur an additional $350,000 in costs directly related to the move (trucking, labor, insurance, etc.) during the third quarter. In the long term, the move to the new fulfillment center is expected, however, to improve customer service and to result in efficiencies and cost savings.

For the three months ended June 30, 2007, technology expenses increased by approximately 21% compared to the three months ended June 30, 2006. This increase resulted from an increase in salary related expenses, as well as an increase in software support, depreciation, training and web hosting expenses. The increase was partially offset by a decrease in consulting expenses as most of the consulting expenses incurred in the second quarter 2007 were related to the development of our new Web site and capitalized accordingly. For the three months ended June 30, 2007, approximately $685,000 of expenses was capitalized in connection with the development of our new Web site.

For the three months ended June 30, 2007, e-commerce expenses decreased by approximately 4% as compared to the three months ended June 30, 2006, primarily due to a decrease in salary related expenses. This decrease was partially offset by increases associated with photo shoots, supplies and research tools. In addition, for the three months ended June 30, 2007, equity based compensation increased compared to the three months ended June 30, 2006, as a result of the Exchange Offer and new equity awards.

GENERAL AND ADMINISTRATIVE EXPENSES: General and administrative expenses for the three months ended June 30, 2007 increased by approximately 7% to $3,454,000 as compared to $3,223,000 for the three months ended June 30, 2006. The increase in general and administrative expenses was primarily the result of the recording of an additional $888,000 of equity based compensation related to equity awards granted during the fourth quarter of 2006 (stock based compensation expense was approximately $1.3 million in the second quarter 2007 compared to $475,000 in the second quarter 2006) as well as increased consulting and professional fees of $65,000, increased recruiting fees of $30,000 and increased depreciation expense of $9,000. These increases were partially offset by a decrease in public company expenses of $97,000 and decreased salary and salary related expenses of $419,000.

As a percentage of net sales, general and administrative expenses for the three months ended June 30, 2007 decreased to approximately 16.0% from 19.2% for the three months ended June 30, 2006.

LOSS FROM OPERATIONS: Operating loss increased in the three months ended June 30, 2007 to $2,249,000 from $1,754,000 in the three months ended June 30, 2006.

INTEREST INCOME: Other income for the three months ended June 30, 2007 increased

to $169,000 from $67,000 for the three months ended June 30, 2006. These amounts related primarily to interest income earned on our cash balances.

INTEREST AND OTHER EXPENSE: Interest expense for the three months ended June 30, 2007 totaled $62,000, compared to $214,000 for the three months ended June 30, 2006. Interest expense for the three months ended June 30, 2006 included fees paid in connection with our Credit Facility, as well as interest expense on our then outstanding promissory notes.

LIQUIDITY AND CAPITAL RESOURCES

General

At June 30, 2007, we had approximately $14.6 million in cash and cash equivalents. Working capital at June 30, 2007 and 2006 was $30.6 million and $37.4 million, respectively. Working capital at December 31, 2006 was $34.0 million. In addition, as of June 30, 2007, we had approximately $3.2 million committed under the Credit Facility, leaving approximately $3.6 million of availability.

We fund our operations through cash on hand, operating cash flow and the proceeds of any equity or debt financing. Operating cash flow is affected by revenue and gross margin levels, as well as return rates, and any deterioration in our performance with respect to these financial measures would have a negative impact on our liquidity. Total availability under the Credit Facility is based primarily upon our inventory levels. In addition, both availability under the Credit Facility and our operating cash flows are affected by the payment terms that we receive from suppliers and service providers, and the extent to which suppliers

require us to request Wells Fargo to provide credit support under the Credit Facility. In some instances, new vendors may require prepayments. We may make prepayments in order to open up these new relationships, or to gain access to inventory that would not otherwise be available to us. In addition, we sometimes make prepayments in connection with our advertising campaign, as in some circumstances we need to pay in advance of production. As of June 30, 2007, we had approximately $569,000 of prepaid inventory on our balance sheet.

Our inventory levels as of June 30, 2007 were approximately $2.0 million higher than at June 30, 2006. The increase in inventory generally reflects a ramp up in connection with our sales growth. However, the increased inventory level could adversely affect our flexibility in taking advantage of other buying opportunities that may become available in the near term. We believe that our current funds, together with operating cash flow, and availability under our existing Credit Facility will be sufficient to enable us to meet our planned expenditures through at least the next 12 months.

Credit Facility

In July 2005, we entered into a new three year revolving credit facility with Wells Fargo. Pursuant to the Credit Facility, Wells Fargo provides us with a revolving loan and issues letters of credit in favor of suppliers or factors. The Credit Facility is secured by a lien on all of our assets. Historically, the Credit Facility had also been secured by the Soros LC. In August 2006, Wells Fargo agreed to release the Soros LC, and that it would no longer require an availability reserve (although it has the right under the Credit Facility to

establish reserves in the future, as it deems appropriate). In return, we agreed to maintain a minimum cash balance of $5,000,000. Availability under the Credit Facility is determined by a formula that takes into account the amount of our inventory and accounts receivable. The maximum availability is currently $7,500,000, but can be increased to $12,500,000 at our request, subject to certain conditions. As of June 30, 2007, total availability under the Credit Facility was approximately $6,800,000 of which $3,200,000 was committed, leaving approximately $3,600,000 available for further borrowings.

Interest accrues monthly on the average daily amount outstanding under the Credit Facility during the preceding month at a per annum rate equal to the prime rate plus 0.75% or LIBOR plus 2.75%. We also pay a monthly commitment fee on the unused portion of the facility (i.e., $7,500,000 less the amount of loans outstanding) equal to 0.35%. We also pay Wells Fargo certain fees to open letters of credit and guarantees in an amount equal to a certain specified percentage of the face amount of the letter of credit for each thirty (30) days such letter of credit, or a portion thereof, remains open.

Commitments and Long Term Obligations

As of June 30, 2007, we had the following commitments and long term obligations:

	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Marketing and Advertising	$ 3,413,000	1,673,000	1,740,000	--	--
Purchase Orders	$ 19,953,000	19,953,000	--	--	--
Operating Leases	$ 1,185,000	490,000	695,000	--	--
Employment Contracts	$ 3,062,000	1,126,000	1,936,000	--	--
Grand total	$ 27,613,000	23,242,000	4,371,000	--	--

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We have assessed our vulnerability to certain market risks, including interest rate risk associated with financial instruments included in cash and cash equivalents. Due to the short-term nature of these instruments we have determined that the risks associated with interest rate fluctuations related to these financial instruments do not pose a material risk to us.

ITEM 4. CONTROLS AND PROCEDURES.

As of the end of the period covered by this Form 10-Q (the "Evaluation Date"), we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer along with our Chief

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

SPECIAL NOTE REGARDING FORWARD LOOKING STATEMENTS

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

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In June 2007, we received a Civil Investigative Demand (the "Discovery Request") from the Federal Trade Commission (the "FTC") that requested the production of certain documents and other information regarding the labeling and advertising of apparel containing products that contain fur or faux fur components. The Discovery Request was issued in connection with a petition filed by the Humane Society of the United States with the FTC regarding the labeling and advertising of fur products by a number of national retailers and apparel manufacturers. The Company is cooperating fully with the Discovery Request.

In addition, we currently and from time to time are involved in litigation incidental to the conduct of our business. However, we are not party to any such litigation that in the opinion of management is likely to have a material adverse effect on us.

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

On May 17, 2007, we held our annual meeting of stockholders. At the meeting, our stockholders voted for nine directors, electing David Wassong, Melissa Payner-Gregor, Barry Erdos, Michael Gross, Ann Jackson, Christopher G. McCann, Martin Miller, Neal Moszkowski and Alex Rafal as members of our board of directors. In addition, our stockholders voted in favor of the following proposals: (1) a proposal to approve amendments to our 2005 Stock Incentive Plan (the "Incentive Plan") to (A) increase the aggregate number of shares of common stock that may be the subject of stock-based awards granted pursuant to the Incentive Plan; (B) increase the aggregate number of shares of common stock that may be the subject of stock-based awards granted pursuant to the Incentive Plan to a participant in a fiscal year, and (C) replace the formula grant of stock options to non-employee directors currently provided for under the Incentive Plan with a formula of restricted stock; (2) a proposal to approve an amendment to our certificate of incorporation to increase the number of authorized shares of common stock and; (3) a proposal to amend our amended and restated certificate of incorporation to effect a reverse stock split of our outstanding common stock at any ratio from 2:1 to 15:1 at anytime prior to the date of our 2008 annual meeting of stockholders, with the board of directors having the sole discretion to determine whether or not to effect such reverse stock split and, if so, at what ratio within the approved range. The results of the voting were as follows:

PROPOSAL	VOTES FOR	VOTES WITHHELD
Election of David Wassong	114,729,044	1,023,323
Election of Melissa Payner-Gregor	114,719,377	1,032,990
Election of Barry Erdos	114,603,059	1,149,308
Election of Christopher G. McCann	114,740,957	1,011,260
Election of Michael Gross	114,348,228	1,404,139
Election of Ann Jackson	114,741,107	1,011,260
Election of Martin Miller	114,242,432	1,509,935
Election of Neal Moszkowski	114,223,761	1,528,606

Election of Alex Rafal	114,343,298	1,409,069

	VOTES FOR	VOTES AGAINST	ABSTENTIONS AND BROKER NON-VOTES
Approval of Amendments to 2005 Stock Incentive Plan	103,125,017	1,157,743	11,469,607
Approval of Amendment to Company's amended and restated certificate of incorporation ("Certificate of Incorporation")	113,934,701	1,783,718	33,947
Approval of an Amendment to the Certificate of Incorporation to effect a Reverse Stock Split	102,539,953	1,727,433	11,484,981

ITEM 6. EXHIBITS

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

EXHIBIT NUMBER	DESCRIPTION
31.1	Certification Pursuant to Rule 13a-14(a)/15d-14(a)
31.2	Certification Pursuant to Rule 13a-14(a)/15d-14(a)
32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

SIGNATURES

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

BLUEFLY, INC.

By: /s/ Melissa Payner-Gregor

Melissa Payner-Gregor
Chief Executive Officer

By: /s/ Patrick C. Barry

Patrick C. Barry
Chief Financial Officer

August 8, 2007