

INNOVO GROUP INC  
Form PREM14A  
April 10, 2006  
UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

**SCHEDULE 14A**

Proxy Statement Pursuant to Section 14(a) of  
the Securities Exchange Act of 1934 (Amendment No. )

Filed by the Registrant  x

Filed by a Party other than the Registrant  o

Check the appropriate box:

- x Preliminary Proxy Statement
- o **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
- o Definitive Proxy Statement
- o Definitive Additional Materials
- o Soliciting Material Pursuant to §240.14a-12

**INNOVO GROUP INC.**

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

- o No fee required.
- x Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.
 

(1)	Title of each class of securities to which transaction applies:
(2)	Aggregate number of securities to which transaction applies:
(3)	Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):
(4)	Proposed maximum aggregate value of transaction: \$10,437,000
(5)	Total fee paid: \$1,116.76
- o Fee paid previously with preliminary materials.
- o Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.
 

(1)	Amount Previously Paid:
(2)	Form, Schedule or Registration Statement No.:
(3)	Filing Party:
(4)	Date Filed:

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## **INNOVO GROUP INC.**

**5804 East Slauson Avenue**

**Commerce, California 90040**

**(323) 725-5516**

April , 2006

Dear Stockholder:

You are cordially invited to attend the 2006 annual meeting of stockholders of Innovo Group Inc., or Innovo Group, which will be held at The Wyndham Commerce Hotel, 5757 Telegraph Road, Commerce, California 90040, (near Los Angeles, California), on Friday, May 12, 2006. The 2006 annual meeting of stockholders will begin promptly at 10:00 a.m. local time.

In addition to the routine matters for our annual meeting, such as the election of directors and appointment of our independent registered public accounting firm, we intend to seek stockholder approval for our proposal to sell certain assets of our private label apparel division.

On March 31, 2006, we entered into an asset purchase agreement to sell to Cygne Designs, Inc., or Cygne, certain assets of our private label apparel division, or the Asset Sale. These assets include the private label apparel division's customer list, all existing purchase orders and inventory related to the private label apparel division and the benefit of a non-compete clause from Azteca Production International, Inc. in favor of us. Cygne has also agreed to hire our current workforce related to the private label apparel division. The aggregate purchase price for these assets is approximately \$10,437,000, subject to adjustment in the event of certain circumstances, which will be paid through the assumption by Cygne of certain liabilities we owe to Azteca Production International, Inc. No cash will be transferred in connection with this transaction.

We are asking you to approve the Asset Sale to Cygne pursuant to the asset purchase agreement. We cannot complete the Asset Sale unless you approve it. Your vote is very important. Whether or not you plan to attend the annual meeting, please take the time to vote by completing and mailing the enclosed proxy card to us. The accompanying proxy statement provides you with detailed information concerning us and the proposed Asset Sale. We encourage you to read carefully the proxy statement, including the section on Risks Related to the Asset Sale beginning on page 43 before voting your shares.

**Our board of directors unanimously recommends that you vote FOR the election of each of the director nominees, the approval of the sale of certain assets of the private label apparel division, the approval of any proposal to adjourn the meeting to a later date, if necessary, to solicit additional proxies if there are not sufficient votes in favor of approval of the Asset Sale, and for the ratification of the appointment of our independent registered public accounting firm.**

On behalf of the Board of Directors, I thank you for your support and continued interest in Innovo Group.

Sincerely,

Samuel J. Furrow  
CHAIRMAN OF THE BOARD OF DIRECTORS  
INNOVO GROUP INC.

*This notice of annual meeting and proxy statement and proxy are first being mailed on or about April , 2006 to our common stockholders.*

## INNOVO GROUP INC.

5804 East Slauson Avenue  
Commerce, California 90040  
(323) 725-5516

### NOTICE OF ANNUAL MEETING OF STOCKHOLDERS TO BE HELD ON FRIDAY, MAY 12, 2006

<b>Time and Date</b>	10:00 a.m., local time on Friday, May 12, 2006
<b>Place</b>	The Wyndham Commerce Hotel, 5757 Telegraph Road, Commerce, California 90040
<b>Items of Business</b>	<p>(1) To elect seven directors to serve on the Board of Directors until the 2007 annual meeting of stockholders or until their respective successors are elected and qualified;</p> <p>(2) To consider and approve the sale of certain assets consisting of our private label apparel division pursuant to an asset purchase agreement by and among Cygne Designs, Inc., Innovo Azteca Apparel, Inc., and Innovo Group Inc. dated as of March 31, 2006. A copy of the asset purchase agreement is included as <u>Exhibit A</u> to the accompanying proxy statement;</p> <p>(3) To consider and approve any proposal to adjourn the meeting to a later date, if necessary, to solicit additional proxies if there are not sufficient votes in favor of approval of the sale of certain assets of the private label apparel division;</p> <p>(4) To ratify the appointment of Ernst &amp; Young, LLP as our independent registered public accounting firm for the fiscal year ending November 25, 2006; and</p> <p>(5) To transact such other business as may properly come before the annual meeting or any adjournments thereof.</p> <p><b>The Board unanimously recommends that you vote to elect all director nominees, approve the sale of assets of our private label apparel division, approve the proposal relating to the adjournment of the meeting and ratify the appointment of auditors as described in detail in the accompanying proxy statement.</b></p>

By Order of the Board of Directors,

Samuel J. Furrow  
Chairman of the Board of Directors  
Commerce, California  
April , 2006

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## SUMMARY

*This summary highlights information contained elsewhere in this proxy statement. This summary may not contain all of the information you should consider before voting on the proposal presented in this proxy statement. You should read the entire proxy statement carefully, including the exhibits attached hereto. For your convenience, cross references are included to direct you to a more complete description of the topics described in this summary.*

*As used in this proxy statement, the terms we, us, and our refer to Innovo Group Inc. and our subsidiaries, Innovo Azteca Apparel, Inc. and/or Joe's Jeans, Inc., as the case may be, unless the context indicates otherwise.*

### The Proposed Asset Sale

On March 31, 2006, we and our Innovo Azteca Apparel, Inc. subsidiary entered into an asset purchase agreement with Cygne Designs, Inc., or Cygne, in which we agreed to sell to Cygne certain assets of our private label apparel division, namely:

- the private label apparel division's customer list, which consists of American Eagle Outfitters, Inc., or AEO, and Target Corporation, or Target;
- all existing purchase orders and inventory related to our private label apparel division; and
- the benefit of a non compete clause with Azteca Production International, Inc., or Azteca, in favor of us.

Cygne has also agreed to hire our current workforce related to our private label apparel division. Collectively, we will refer to this as the Asset Sale. We agreed to sell these assets, which represent a substantial part, but not all, of our assets to Cygne. In exchange for the purchased assets, Cygne has agreed to assume certain liabilities associated with our private label apparel division, namely, the remaining obligation under the original promissory note executed in favor of Azteca under the asset purchase agreement pursuant to which we originally purchased the private label apparel assets, or the Blue Concept asset purchase agreement, the obligation to continue to pay the earn-out royalty under the Blue Concept asset purchase agreement, all other liabilities, excluding the original promissory note, that we may owe to Azteca in excess of \$1,500,000, and all liabilities associated with our outstanding purchase orders and inventory schedules listed in the asset purchase agreement, or collectively, the Assumed Liabilities. The aggregate value of the Assumed Liabilities, which will represent the purchase price for the transaction, is approximately \$10,437,000, subject to certain adjustments related to the aggregate value of liabilities we may owe Azteca as of the closing date and payment of certain audit related fees. No cash will be transferred in connection with this transaction.

Our stockholders are being asked to approve the Asset Sale pursuant to the asset purchase agreement. The asset purchase agreement is attached as *Exhibit A* to this proxy statement. We encourage all of our stockholders to read the asset purchase agreement carefully and fully, as it is the legal document that governs the Asset Sale.

### Recommendation of the Board of Directors

Our Board of Directors unanimously recommends a vote **FOR** the approval of the sale of certain assets of our private label apparel division to Cygne pursuant to the asset purchase agreement.

### Votes Required

The approval of the Asset Sale requires the affirmative vote of the holders of a majority of our outstanding shares of common stock entitled to vote on the proposal. See "The Proposed Asset Sale Recommendation of our Board of Directors" beginning on page 24.

This proxy statement and notice of proxy are being mailed to all stockholders entitled to vote at our annual meeting on or about April , 2006.

### **Our Reasons for the Asset Sale**

We decided to sell the assets related to our private label apparel division after we evaluated several factors, including (i) our expected net sales from our existing private label apparel customers, (ii) the cost of operation related to our private label apparel division, and (iii) projected cash flows from operations. Based upon this evaluation, we realized that our private label apparel division's net sales would continue to decrease for the foreseeable future and we could not see the potential for us in the private label apparel division's business. Further, in order to increase sales, we would have to seek new customers which would require investment by us since we do not have the requisite sales force to allow us to compete for new business. In contrast, our branded apparel division, led by our Joe's Jeans® branded apparel line, has shown significant growth potential. Rather than continue to invest in our private label apparel business, we believed that our best course of action was to pursue other opportunities which would offer greater growth potential, such as focusing on our Joe's Jeans® branded apparel line. See *The Proposed Asset Sale Background for the Asset Sale and Our Reasons for the Asset Sale* beginning on page 21.

### **Opinion of The Mentor Group Inc.**

In making our determination with respect to the Asset Sale, our Board of Directors relied upon, among other things, the opinion of our financial advisor, The Mentor Group, Inc., or The Mentor Group. Our Board of Directors received a written opinion dated as of March 31, 2006 from The Mentor Group to the effect that, as of that date and based on and subject to the assumptions and qualifications described in its opinion, the aggregate purchase price of approximately \$10,437,000, subject to adjustment, which represents the aggregate value of the Assumed Liabilities, was fair, from a financial point of view, to our stockholders. A copy of the opinion, which is attached as *Exhibit B* to this proxy statement, sets forth the procedures followed, assumptions made, matters considered and the review undertaken with respect to the opinion. See *The Proposed Asset Sale Fairness Opinion of our Financial Advisor* beginning on page 24.

### **Use of Proceeds**

At the closing, Cygne will assume and be responsible for all of the Assumed Liabilities, namely, the remaining obligation under the original promissory note executed in favor of Azteca under the Blue Concept asset purchase agreement, the obligation to continue to pay the earn out royalty under the Blue Concept asset purchase agreement, all liabilities, excluding the original promissory note, that we may owe to Azteca in excess of \$1,500,000 and all liabilities associated with our outstanding purchase orders and inventory schedules listed in the asset purchase agreement. We will enter into an assignment and assumption agreement with Cygne, which will be acknowledged by Azteca at closing to effectuate this assignment of the benefit of the non-compete clause and the assumption of the Assumed Liabilities. No cash will be transferred in connection with this transaction. See *The Proposed Asset Sale Use of Proceeds* beginning on page 26.

### **Conditions to the Completion of the Asset Sale**

Completion of the Asset Sale requires, among other things, the approval by our stockholders holding a majority of our outstanding shares of common stock entitled to vote on the proposal. Additional conditions to the closing of the Asset Sale include the satisfaction or waiver by the parties of customary conditions set forth in the asset purchase agreement. See *The Asset Purchase Agreement Closing Conditions* beginning on page 32.

### **Termination of the Purchase Agreement**

The asset purchase agreement may be terminated by us or Cygne in certain circumstances, in which case the Asset Sale will not be completed. See *The Asset Purchase Agreement Termination of the Asset Purchase Agreement* beginning on page 33.

### **Risk Factors**

The Asset Sale and our ongoing operations involve a number of risks, including:

#### *Risks Related to the Asset Sale*

- If conditions to close are not met, we will not complete the Asset Sale.
- Substantial expenses will be incurred and payments made event if the Asset Sale is not consummated.
- The pro forma financial statements are presented for illustrative purposes only and may not be an indication of our financial condition or results of operations following the Asset Sale.
- Our stockholders do not have any appraisal rights under Delaware law.
- If our stockholders do not approve the Asset Sale we may have to continue to operate our private label apparel division and retain the liabilities associated with it, including approximately \$7,937,000 of debt owed to Azteca.
- If our stockholders do not approve the Asset Sale we believe we will still need stockholder approval under Delaware law to exit or cease our operation of our private label apparel division.
- We may not be successful in implementing our strategic plan to focus our resources on our best performing asset, our Joe's Jeans® brand.
- Failure to complete the Asset Sale could cause our stock price to decline.

You should read and consider carefully the information about these and other risks set forth under the caption *Risk Factors* beginning on page 43.

## STATEMENTS REGARDING FORWARD-LOOKING INFORMATION

This proxy statement contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements relate to the financial condition, results of operations, cash flows, financing plans, business strategies, capital and other expenditures, competitive positions, growth opportunities for existing products, plans and objectives of management and other matters. Statements in this document that are not historical facts are identified as forward-looking statements for the purpose of the safe harbor provided by Section 21E of the Securities Exchange Act of 1934 and Section 27A of the Securities Act of 1933.

When we use the words anticipate, estimate, project, intend, expect, plan, believe, should, likely and similar expressions, we are making forward-looking statements. These forward-looking statements are found at various places throughout this proxy statement and the other documents we incorporate by reference in this proxy statement. We caution you not to place undue reliance on these forward-looking statements, which speak only as of the date they were made. We do not undertake any obligation to publicly release any revisions to these forward-looking statements to reflect events or circumstances after the date of this proxy statement or to reflect the occurrence of unanticipated events.

These forward-looking statements, including statements relating to future business prospects, revenues, working capital, liquidity, capital needs, interest costs and income, wherever they occur in this proxy statement, are estimates reflecting our best judgment. These forward-looking statements involve a number of risks and uncertainties that could cause actual results to differ materially from those suggested by the forward-looking statements. Forward-looking statements should, therefore, be considered in light of various important factors, including those set forth in this proxy statement and those discussed from time to time in our Securities and Exchange Commission, or SEC, reports, including our annual report on Form 10-K for the year ended November 26, 2005 filed with the SEC on February 9, 2006. Important factors that could cause actual results to differ materially from estimates or projections contained in the forward-looking statements include, without limitation:

- If conditions to close are not met, we will not complete the Asset Sale.
- Substantial expenses will be incurred and payments made event if the Asset Sale is not consummated.
- The pro forma financial statements are presented for illustrative purposes only and may not be an indication of our financial condition or results of operations following the Asset Sale.
- Our stockholders do not have any appraisal rights under Delaware law.
- If our stockholders do not approve the Asset Sale, we may have to continue to operate our private label apparel division and retain the liabilities associated with it, including approximately the \$7,937,000 of debt owed to Azteca.
- If our stockholders do not approve the Asset Sale, we believe we will still need stockholder approval under Delaware law to exit or cease our operation of our private label apparel division.
- We may not be successful in implementing our strategic plan to focus our resources on our best performing asset, our Joe's Jeans® brand.
- Failure to complete the Asset Sale could cause our stock price to decline.

You should read and consider carefully the information about these and other risks set forth under the caption Risk Factors beginning on page 43.



**QUESTIONS AND ANSWERS  
ABOUT THE PROXY MATERIALS  
AND THE ANNUAL MEETING**

Although we encourage you to read the proxy statement in its entirety, we include these Questions and Answers to provide background information and brief answers to several questions that you may have about the proxy materials in general.

**Q: Why am I receiving these materials?**

**A:** The Board of Directors of Innovo Group, or our Board of Directors, is providing these proxy materials to you in connection with our annual meeting of stockholders, which will take place on Friday, May 12, 2006. Our common stockholders are invited to attend the annual meeting and are entitled to and requested to vote on the proposals described in this proxy statement.

**Q: What information is contained in this proxy statement?**

**A:** The information included in this proxy statement relates to the proposals to be voted on at the annual meeting, the voting process, information including compensation concerning directors and our most highly paid executive officers, and certain other required information.

**Q: What proposals will be voted on at the annual meeting?**

**A:** The proposals scheduled to be voted on at the annual meeting are:

- (1) To elect seven directors to serve on the Board of Directors until the 2007 annual meeting of stockholders or until their respective successors are elected and qualified;
- (2) To consider and approve the sale of certain assets of our private label apparel division pursuant to an asset purchase agreement by and among Cygne Designs, Inc., Innovo Azteca Apparel, Inc., and Innovo Group Inc. dated as of March 31, 2006, a copy of which is attached hereto as *Exhibit A*;
- (3) To consider and approve any proposal to adjourn the meeting to a later date, if necessary, to solicit additional proxies if there are not sufficient votes in favor of approval of the sale of certain assets of our private label apparel division; and
- (4) To ratify the appointment of Ernst & Young, LLP as our independent registered public accounting firm for the fiscal year ending November 25, 2006.

We will also consider any other business that properly comes before the annual meeting.

**Q: How does the Board of Directors recommend that I vote?**

**A:** Our Board of Directors unanimously recommends that you vote your shares:

- **FOR** each of the nominees to the Board of Directors;
- **FOR** the approval and sale of certain assets of our private label apparel division;
- **FOR** any proposal to adjourn the meeting to a later date, if necessary, to solicit additional proxies if there are not sufficient votes in favor of approval of the sale of certain assets of our private label apparel division; and

- **FOR** the ratification of the appointment of Ernst & Young, LLP as our independent registered public accounting firm for the fiscal year ending November 25, 2006.

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**Q: What shares can I vote?**

**A:** Each share of our common stock issued and outstanding as of the close of business on April 12, 2006, or the Record Date, is entitled to vote for all proposals being voted upon at the annual meeting. You may cast one vote per share of common stock held by you as of the Record Date. These shares include shares that are (1) held directly in your name as the common stockholder of record, and (2) shares held for you as the beneficial owner through a broker, bank or other nominee. As of April 7, 2006, we had approximately 33,301,787 shares of common stock issued and outstanding and 909 common stockholders of record.

**Q: What is the difference between holding shares as a common stockholder of record and as a beneficial owner?**

**A:** Most of our common stockholders hold their shares through a broker, bank or other nominee rather than directly in their own name. As summarized below, there are some distinctions between shares held of record and those owned beneficially.

**Common Stockholder of Record**

If your shares are registered directly in your name with our transfer agent, North American Transfer Company, you are considered with respect to those shares the common stockholder of record and these proxy materials are being sent directly to you by us. As the common stockholder of record, you have the right to grant your voting proxy directly to us or to vote in person at the annual meeting. We have enclosed a proxy card for you to use.

**Beneficial Owner**

If your shares are held in a brokerage account or by a bank or other nominee, you are considered the beneficial owner of shares of our common stock held in street name, and these proxy materials are being forwarded to you by your broker, bank or nominee who is considered with respect to those shares the common stockholder of record. As the beneficial owner, you have the right to direct your broker, bank or other nominee on how to vote and are also invited to attend the annual meeting. However, since you are not the common stockholder of record, you may not vote these shares in person at the annual meeting unless you obtain a legal proxy from the broker, bank, or nominee that holds your shares giving you the right to vote the shares at the annual meeting. Your broker, bank or nominee has enclosed a voting instruction card for you to use in directing the broker or nominee regarding how to vote your shares. You may also be able to vote your shares by Internet or telephone as described below under [How can I vote my shares without attending the annual meeting?](#)

**Q: How can I attend the annual meeting?**

**A:** You are entitled to attend the annual meeting only if you are an Innovo Group common stockholder as of the close of business on Record Date or you hold a valid proxy for the annual meeting. You should be prepared to present photo identification for admittance. If you are not a common stockholder of record, but hold the shares through a broker, bank or nominee (i.e., in street name), you should provide proof of beneficial ownership on the Record Date, such as your most recent account statement prior to April 12, 2006, a copy of the voting instruction card provided by your broker, bank or nominee, or other similar evidence of ownership. If you do not provide photo identification or comply with the other procedures outlined above upon request, you will not be admitted to the annual meeting.

**Q: How can I vote my shares in person at the annual meeting?**

**A:** Shares held in your name as the common stockholder of record may be voted in person at the annual meeting. Shares held beneficially in street name may be voted in person only if you obtain a legal proxy from your broker, bank or other nominee that holds your shares giving you the right to vote the shares. *Even if you plan to attend the annual meeting, we recommend that you also submit your proxy or voting instructions as described below so that your vote will be counted if you later decide not to attend the meeting.*

**Q: How can I vote my shares without attending the annual meeting?**

**A:** Whether you hold your shares directly as the common stockholder of record or beneficially in street name, you may direct how your shares are voted without attending the meeting. If you are a common stockholder of record, you may vote by submitting a proxy. If you hold shares beneficially in street name, you may vote by submitting voting instructions to your broker, bank or nominee. For directions on how to vote, please refer to the instructions below and those included on your proxy card, or for shares held beneficially in street name, you may vote by submitting voting instructions to your broker, bank or nominee.

**By Mail** Our common stockholders of record may submit proxies by completing, signing and dating their proxy cards and mailing them in the accompanying pre-paid, pre-addressed envelope. Our common stockholders who hold shares beneficially in street name may vote by mail by completing, signing and dating the voting instruction card provided by their broker, bank or nominee and mailing them in the accompanying pre-addressed envelope.

**By Internet** Most of our common stockholders who hold shares beneficially in street name may vote by accessing the website specified on the voting instruction cards provided by their brokers, banks or nominees. Please check the voting instruction card for Internet voting availability.

**By Telephone** Most of our common stockholders who hold shares beneficially in street name may vote by phone by calling the number specified on the voting instruction cards provided by their brokers, banks or nominees. Please check the voting instruction card for telephone voting availability.

**Q: May I change my vote?**

**A:** You may change your vote at any time prior to the vote at the annual meeting. If you are a common stockholder of record, you may change your vote by granting a new proxy card bearing a later date (which automatically revokes the earlier proxy), by providing written notice of revocation to our Corporate Secretary prior to your shares being voted, or by attending the annual meeting and voting in person. Attendance at the annual meeting will not cause your previously granted proxy to be revoked unless you specifically so request. For shares you hold beneficially in street name, you may change your vote by submitting new voting instructions to your broker, bank or nominee, or, if you have obtained a legal proxy from your broker, bank or nominee giving you the right to vote your shares, by attending the meeting and voting in person.

**Q: Is my vote confidential?**

**A:** Proxy instructions, ballots and voting tabulations that identify individual common stockholders are handled in a manner that protects your voting privacy. Your vote will not be disclosed either within our company or to third parties, except: (1) as necessary to meet applicable legal requirements, (2) to allow for the tabulation of votes and certification of the vote, and (3) to facilitate a successful proxy solicitation. If a common stockholder submits a proxy card with a written comment, then that proxy card will be forwarded to our management.



**Q: How many shares must be present or represented to conduct business at the annual meeting?**

**A:** The quorum requirement for holding the annual meeting and for transacting business is that the holders of a majority of shares of our common stock entitled to vote must be present in person or represented by proxy. Both abstentions and broker non-votes are counted for the purposes of determining the presence of a quorum.

**Q: How are votes counted?**

**A:** For the election of directors, you may vote **FOR** all of the nominees or your vote may be **WITHHELD** for one or more of the nominees. For the other items of business, you may vote **FOR**, **AGAINST** or **ABSTAIN**. If you **ABSTAIN**, the abstention has the same effect as a vote **AGAINST** the proposal. If you provide specific instructions with regard to certain items, your shares will be voted as you instruct on such items. If you sign your proxy card or voting instruction card without giving specific instructions, your shares will be voted in accordance with the recommendations of the Board of Directors.

**Q: Who will count the vote?**

**A:** A representative of North American Transfer Company will tabulate the votes up until the morning of the meeting. At the meeting, our inspector of election will tabulate the votes.

**Q: Who will serve as inspector of election?**

**A:** Mr. Dustin Huffine, our Corporate Secretary, will serve as our inspector of election.

**Q: What is the voting requirement to approve each of the proposals?**

**A:** For the election of directors, the seven persons receiving a plurality of **FOR** votes at the annual meeting will be elected. For the approval of the sale of our private label apparel assets, the proposal requires the affirmative **FOR** vote of a majority of our issued and outstanding common stock entitled to vote on the proposal. All other proposals require the affirmative **FOR** vote of a majority of those shares present in person or represented by proxy and entitled to vote on those proposals at the annual meeting. If you hold shares beneficially in street name and do not provide your broker with voting instructions, your shares may constitute broker non-votes. Generally, broker non-votes occur on a matter when a broker is not permitted to vote on that matter without instructions from the beneficial owner and instructions are not given. Brokers may not vote shares on Proposal 2 and Proposal 3 without instructions from the beneficial owner of such shares. If the broker is not instructed with respect to Proposal 2 or Proposal 3, the shares will constitute broker non-votes. In tabulating the voting results for any particular proposal, shares that constitute broker non-votes are not considered entitled to vote on that proposal. Thus, broker non-votes will not be counted in the vote total. Abstentions have the same effect as votes against the matter. Broker s may vote your shares with respect to Proposal 1 and Proposal 4, since it is a routine matter.

**Q: What happens if additional proposals are presented at the annual meeting?**

**A:** Other than the four proposals described in this proxy statement, we are not aware of any other business to be acted upon at the annual meeting. If you grant a proxy, the person named as proxyholder, Marc Crossman, will have the discretion to vote your shares on any additional matters properly presented for a vote at the meeting. If for any unforeseen reason any of our nominees for our Board of Directors is not available as a candidate, the persons named as proxyholders will vote your proxy for such other candidate or candidates as may be nominated by the Board of Directors.



**Q: What should I do if I receive more than one set of voting materials?**

**A:** You may receive more than one set of voting materials, including multiple copies of this proxy statement and multiple proxy cards or voting instruction cards. For example, if you hold your shares in more than one brokerage account, you may receive a separate voting instruction card for each brokerage account in which you hold shares. If you are a common stockholder of record and your shares are registered in more than one name, you will receive more than one proxy card. Please complete, sign, date and return each proxy card and voting instruction card that you receive.

**Q: Who will bear the costs of soliciting votes for the annual meeting?**

**A:** We are making this solicitation and will pay the entire cost of preparing, assembling, printing, mailing and distributing these proxy materials and soliciting votes. In addition to the mailing of these proxy materials, the solicitation of proxies or votes may be made in person, by telephone or by electronic communication by our directors, officers and employees, who will not receive any additional compensation for such solicitation activities.

To further assist in the solicitation process, we expect to hire The Altman Group, Inc. to solicit proxies by personal interviews, telephone, telegram or otherwise. In the event we hire The Altman Group, Inc. to assist with the solicitation of proxies, we anticipate that we would be expected to pay The Altman Group, Inc. an initial fee of approximately \$5,500, plus additional compensation for telephone solicitation and solicitations made by other means.

**Q: Where can I find the results of the annual meeting?**

**A:** We will announce preliminary voting results at the annual meeting and publish final results in a Current Report on Form 8-K to be filed with the Securities and Exchange Commission, or SEC, within four days after the annual meeting.

**Q: Where can I obtain a copy of Innovo Group's Annual Report on Form 10-K and Amendment No. 1 to Innovo Group's Annual Report on Form 10-K for the year ended November 26, 2005?**

**A:** A copy of our Annual Report on Form 10-K and Amendment No.1 to our Annual Report on Form 10-K for the year ended November 26, 2005 is enclosed with this proxy statement.

**Q: What if I share an address with another common stockholder?**

**A:** In some instances, we may deliver to multiple common stockholders sharing a common address only one copy of this proxy statement and its attachments. If requested by phone or in writing, we will promptly provide a separate copy of the proxy statement and its attachments to a common stockholder sharing an address with another common stockholder. Requests by phone should be directed to our Corporate Secretary at (323) 725-5516 and requests in writing should be sent to Innovo Group Inc., Attention: Corporate Secretary, 5804 East Slauson Avenue, Commerce, California 90040. Our common stockholders sharing an address who currently receive multiple copies and wish to receive only a single copy should contact their broker or send a signed, written request to us at the address above.

**Q: What is the deadline to propose actions for consideration at next year's annual meeting of stockholders or to nominate individuals to serve as directors?**

**A:** You may submit proposals, including director nominations, for consideration at future common stockholder meetings. We expect to hold our 2007 annual meeting of stockholders on or around mid-May to early-June of 2007.



Our common stockholders may submit proposals that they believe should be voted upon at the 2007 annual meeting consistent with regulations of the SEC and our bylaws.

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Pursuant to Rule 14a-8 under the Securities Exchange Act of 1934, some stockholder proposals may be eligible for inclusion in our 2007 proxy statement. Any such stockholder proposals must be submitted in writing to and received by the Corporate Secretary of Innovo Group at 5804 East Slauson Avenue, Commerce, California 90040 no later than January 2, 2007. The submission of a stockholder proposal does not guarantee that it will be included in our proxy statement.

A stockholder may also submit a proposal for consideration outside of Rule 14a-8. Pursuant to Rule 14a-4(c)(1), a stockholder may submit a proposal for consideration at the annual meeting. Any such stockholder proposals to be considered at the annual meeting must be submitted in writing to and received by our Corporate Secretary no later than March 18, 2007 to be considered timely. The submission of a stockholder proposal does not guarantee that it will be presented at the annual meeting.

Our common stockholders interested in submitting a proposal are advised to contact knowledgeable legal counsel with regard to the detailed requirements of applicable federal securities laws and the our bylaws, as applicable.

**Q: Do I have any appraisal rights under the General Corporation Law of the State of Delaware?**

**A:** Under the General Corporation Law of the State of Delaware, you do not have any appraisal rights in connection with any of proposals upon which a vote is scheduled to be taken at this annual meeting of stockholders.

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## INNOVO GROUP INC.

5804 East Slauson Avenue  
Commerce, California 90040

## PROXY STATEMENT

ANNUAL MEETING OF STOCKHOLDERS TO BE HELD ON  
FRIDAY, MAY 12, 2006

### PROPOSAL 1

#### ELECTION OF DIRECTORS

Our bylaws provide that our Board of Directors will consist of not less than three directors, with the exact number of directors (subject to such minimum and any range of size established by our common stockholders) to be determined by resolution of our Board of Directors. Currently, our Board of Directors has set the number of directors at seven directors. At our annual meeting, seven directors will be elected to serve until the 2007 annual meeting of stockholders, which we expect to hold around mid-May to early-June 2007. Our Board of Directors' nominees for election are set forth below.

In connection with investments by Commerce Investment Group, LLC and other investors affiliated with two of our common stockholders, Hubert Guez and Paul Guez, or collectively, the Commerce Group, during August and October 2000, we entered into an investor rights agreement whereby Commerce Group has the right to nominate three individuals for election to our Board of Directors. Additionally, one of Commerce Group's nominees, if elected, will have the right to serve on each of the committees of our Board of Directors. At this time, Commerce Group has not nominated any person to serve as a member on our Board of Directors. Joseph Mizrachi, pursuant to investments made in October 2000, has the right to nominate one individual for election to our Board of Directors, with this individual having the right to serve on the committees of our Board of Directors if elected. Mr. Mizrachi, at this time, has not nominated any person to be elected as a member of our Board of Directors.

**Q: What is the vote required to approve Proposal 1?**

**A:** Our Board of Directors will be elected by a plurality vote. Unless otherwise instructed on the proxy, properly executed proxies will be voted for the election of all of the director nominees set forth below. Our Board of Directors believes that all such nominees will stand for election and will serve if elected. However, if any of the persons nominated by the Board of Directors fails to stand for election or is unable to accept election, proxies will be voted by the proxy holders for the election of such other person or persons as the Board of Directors may recommend.

**Q: How does the Board of Directors recommend I vote?**

**A:** Our Board of Directors unanimously recommends a vote **FOR** the director nominees listed below.

**Q: What information is provided with respect to nominees to the Board of Directors?**

A: The following table sets forth information regarding our nominees to our Board of Directors:

Name	Age	Position	Year First Elected Director
Samuel J. (Sam) Furrow	65	Chairman of the Board of Directors	1998
Marc B. Crossman	34	Interim Chief Executive Officer, President, Chief Financial Officer and Director	1999
Samuel J. (Jay) Furrow, Jr.	32	Director	1999
Kelly Hoffman(1)(2)(3)	47	Director	2004
Tom O Riordan	49	Director	2006
Suhail R. Rizvi(1)(2)(3)	40	Director	2003
Kent Savage(1)(2)(3)	44	Director	2003

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- (1) Member of the Audit Committee
- (2) Member of the Compensation and Stock Option Committee
- (3) Member of the Nominating and Governance Committee

**Q: What is the business experience of the nominees for election to our Board of Directors?**

A: The business experience of our nominees for election to our Board of Directors is as follows:

*Samuel J. (Sam) Furrow* has served as Chairman of our Board of Directors since October 1998. Mr. Furrow became a member of our Board of Directors in April 1998 and served as our Chief Executive Officer from October 1998 until December 2000. Mr. Furrow also has been Chairman of the Board of Furrow Auction Company, a real estate and equipment sales company with its headquarters in Knoxville, Tennessee, since April 1968; Chairman of Furrow-Justice Machinery Corporation, a six-branch industrial and construction equipment dealer, since 1983; owner of Knoxville Motor Company-Mercedes Benz and Land Rover of Knoxville since December 1980 and July 1997, respectively. Mr. Furrow received his undergraduate and J.D. degree from the University of Tennessee. Sam Furrow is the father of our former Chief Executive Officer and Director, Samuel J. (Jay) Furrow, Jr.

*Samuel J. (Jay) Furrow, Jr.* has served as a member of our Board of Directors since January 1999. From July 2002 until January 2006, Mr. Furrow served as our Chief Executive Officer, from December 2000 until July 2002 as our President, from April 1999 until March 2003 as our Chief Operating Officer, from August 2000 until March 2003 as our Acting Chief Financial Officer, and from August 1998 until April 1999 as our Vice-President for Corporate Development and In-House Counsel. Mr. Furrow currently serves on the Board of Directors of Digital Lifestyles Group, Inc. (DLFG.PK), a publicly traded manufacturer and distributor of consumer electronics and VTV: Varsity Television, Inc., a television company and network dedicated to teenagers. Mr. Furrow received his J.D. degree from Southern Methodist University School of Law and his B.S. degree in Political Science from Vanderbilt University. Jay Furrow is the son of the Chairman of our Board of Directors, Samuel J. (Sam) Furrow.

*Marc B. Crossman* has served as our Interim Chief Executive Officer since January 2006, our Chief Financial Officer since March 2003, our President since September 2004 and a member of our Board of Directors since January 1999. From January 1999 until March 2003, Mr. Crossman served as a Vice President and Equity Analyst with J.P. Morgan Securities Inc., New York City, New York. From September 1997 until January 1999, Mr. Crossman served as a Vice President and Equity Analyst with



CIBC Oppenheimer Corporation. Mr. Crossman received his B.S. degree in Mathematics from Vanderbilt University.

**Kelly Hoffman** has served as a member of our Board of Directors since June 2004. Mr. Hoffman has served as Chairman of the Board of Directors and Chief Executive Officer of VTV: Varsity Television, a television company and network dedicated to teenagers, since he founded the company in 1998. From 1991 until 1998, Mr. Hoffman owned AOCO Operating, a company that raised capital for the acquisition of property in Texas, Louisiana and New Mexico. From 1989 until 1991, Mr. Hoffman served in a similar position for Texakoma Financial, an oil and gas partnership that raised capital for acquisition of property in Texas, Louisiana and New Mexico. Prior to that, Mr. Hoffman served in various sales and marketing positions for PAZ Syndicate, a conglomerate based in Tel Aviv, Israel that owned diverse interests worldwide. Prior to that, Mr. Hoffman specialized in securing capital from investors for investment in various limited partnerships for the oil and gas industry for Paso Energy. Mr. Hoffman began his oil and gas career at Amoco Production Company in Texas in various positions. Mr. Hoffman attended Texas Tech University and majored in Business Administration.

**Tom O Riordan** has served as a member of our Board of Directors since April 2006. Since 2004, Mr. O Riordan has acted in an executive consulting and advisory capacity to the senior management team of Fila Holding Company, a publicly traded manufacturer and retailer of branded footwear, apparel and accessories, and to other investment advisors and funds in the retail and consumer products sector. From 1999 to 2004, Mr. O Riordan served in various executive management capacities with Fila Holding Company, ultimately serving as Chief Executive Officer from 2003 to 2004. From 1995 until 1998, Mr. O Riordan served as Director of Operations of Adidas America, a publicly traded manufacturer and retailer of branded athletic footwear, apparel and accessories. From 1988 to 1995, Mr. O Riordan was President of Tom O Riordan & Associates, a sales and marketing company focused on the athletic footwear, apparel and sporting goods industries. Mr. O Riordan began his career in sales for Brooks Shoe Company. Mr. O Riordan received his B.S. degree in Marketing and Management from Rider University.

**Suhail R. Rizvi** has served as a member of our Board of Directors since April 2003. Since 2004, Mr. Rizvi has served as founder and Chief Investment Officer of Rizvi/Traverse Management LLC and other related funds. Mr. Rizvi has over twenty years of private equity investing experience for his own account and as a fiduciary for institutional investors through various entities or funds as founder, principal or manager. Mr. Rizvi also serves as Chairman of the Board of Directors of AG Holdings, a diversified investment company with interests in various manufacturing companies. Mr. Rizvi also serves as a member of the Board of Directors for International Creative Management, Inc. a global talent and literary agency. Mr. Rizvi received his B.S. degree in Economics from the Wharton School of the University of Pennsylvania and sits on the Wharton Undergraduate Executive Board.

*Kent Savage* has served as a member of our Board of Directors since July 2003. Mr. Savage served as Chief Executive Officer for Digital Lifestyles Group, Inc. (DLFG.PK), a publicly traded manufacturer and distributor of personal computers from January 2004 until June 2005. From September 2002 until February 2003, Mr. Savage served as co-founder, Chief Sales and Marketing Officer for TippingPoint Technologies (NASDAQ: TPTI). From February 1999 until August 2001, Mr. Savage served as co-founder, CEO and President for Netpliance, Inc. From April 1998 until February 1999, Mr. Savage served as General Manager, Broadband for Cisco Systems Inc. Service Provider Line of Business. From July 1996 until April 1998, Mr. Savage served as Vice President, Sales and Marketing for NetSpeed, Inc. Mr. Savage received his B.S. degree in Business from Oklahoma State University, attended University of Virginia's Executive Leadership Program, and received his M.B.A. degree from Southern Methodist University.

**Q: How are the Board of Directors elected and how many meetings were held in fiscal 2005?**

**A:** Each member of our Board of Directors is elected at the annual meeting of stockholders and serves until the next annual meeting of stockholders and until a successor has been elected and qualified or his earlier death, resignation or removal. Vacancies on the Board of Directors are filled by a majority vote of the remaining Board of Directors. Our Board of Directors manages us through board meetings and through its committees. During fiscal 2005, our Board of Directors met or acted through written consent a total of eight times. No incumbent member of our Board of Directors who served as a director in fiscal 2005 attended in person or via teleconference less than 75% of all the meetings of our Board of Directors and the committees on which he served during fiscal 2005. Although we do not have a formal policy regarding attendance at our annual meeting of stockholders, we attempt to accommodate the schedules of each member of our Board of Directors in choosing a date for our annual meeting of stockholders and our annual meeting of our Board of Directors. In fiscal 2005, all of our members of our Board of Directors attended the annual meeting of our Board of Directors either in person or via teleconference.

**Q: What committees does the Board of Directors have?**

**A:** Our Board of Directors has an Audit Committee, Compensation and Stock Option Committee and Nominating and Governance Committee.

*Audit Committee.* The Audit Committee is currently comprised of Messrs. Rizvi, Hoffman and Savage. Mr. Rizvi serves as Chairman of the Audit Committee. The Audit Committee met or acted through written consent a total of seven times in fiscal 2005.

The Audit Committee has been established to: (a) assist our Board of Directors in its oversight responsibilities regarding (1) the integrity of our financial statements, (2) our compliance with legal and regulatory requirements, (3) the independent accountant's qualifications and independence and (4) the performance of the our internal audit function; (b) prepare the report required by the SEC for inclusion in the our annual proxy statement; (c) retain and terminate our independent accountant; (d) approve audit and non-audit services to be performed by the independent accountant; and (e) perform such other functions as our Board of Directors may from time to time assign to the Audit Committee. The Audit Committee has a charter that details its duties and responsibilities, which was adopted by our Board of Directors on May 22, 2003 and filed with our revised proxy statement for our last annual meeting on April 29, 2004. Currently, all Audit Committee members are independent under NASDAQ listing standards and as such term is defined in the rules and regulations of the SEC, and Mr. Rizvi has also been designated to be an audit committee financial expert as such term is defined in the rules and regulations of the SEC. A copy of the Audit Committee charter can be found on our website at [www.innovogroup.com](http://www.innovogroup.com) under our Investor Relations heading.





**Compensation and Stock Option Committee.** Currently, the Compensation Committee is comprised of Messrs. Rizvi, Hoffman and Savage. Mr. Rizvi serves as Chairman of the Compensation Committee. The Compensation and Stock Option Committee met or acted through written consent a total of five times in fiscal 2005.

The principal responsibilities of the Compensation and Stock Option Committee are to (a) assist our Board of Directors in ensuring that a proper system of long-term and short-term compensation is in place to provide performance-oriented incentives to management, and that compensation plans are appropriate and competitive and properly reflect the objectives and performance of management and the company; (b) discharge our Board of Directors' responsibilities relating to compensation of our executive officers; (c) evaluate our Chief Executive Officer and set his remuneration package; (d) prepare an annual report on executive compensation for inclusion in our annual proxy statement; (e) make recommendations to our Board of Directors with respect to incentive-compensation plans and equity-based plans; and (f) perform such other functions as our Board of Directors may from time to time assign. The Compensation and Stock Option Committee has a charter that details its duties and responsibilities, which was adopted by our Board of Directors on May 22, 2003. Currently, all Compensation and Stock Option Committee members are independent under NASDAQ listing standards. A copy of the Compensation and Stock Option Committee charter can be found on our website at [www.innovogroup.com](http://www.innovogroup.com) under our Investor Relations heading.

**Nominating and Governance Committee.** The Nominating and Governance Committee is currently comprised of Messrs. Hoffman, Rizvi and Savage. Mr. Hoffman serves as Chairman of the Nominating and Governance Committee. The Nominating and Governance Committee met a total of one time in fiscal 2005 and met on April 7, 2006 to propose a slate of nominees for election to our Board of Directors by our common stockholders for this annual meeting.

The principal responsibilities of the Nominating and Governance Committee are to (a) assist our Board of Directors in determining the desired experience, mix of skills and other qualities to assure appropriate Board composition, taking into account the current Board members and the specific needs of the company and the Board of Directors; (b) identifying highly qualified individuals meeting those criteria to serve on our Board of Directors; (c) proposing to our Board of Directors a slate of nominees for election by our common stockholders at the annual meeting of stockholders and prospective director candidates in the event of the resignation, death, removal or retirement of directors or a change in our Board of Directors composition requirements; (d) developing plans regarding the size and composition of our Board of Directors and its committees; (e) reviewing management succession plans; (f) reviewing the Corporate Governance Guidelines of our Board of Directors at least annually and monitoring and making recommendations with respect to the corporate governance principles applicable to the company; and (g) such other functions as the Board of Directors may from time to time assign to the Nominating and Governance Committee.

The Nominating and Governance Committee has a charter that details its duties and responsibilities, which was adopted by our Board of Directors on May 22, 2003. Currently, all Nominating and Governance Committee members are independent under NASDAQ listing standards. There is no specific procedure outlined in the charter for the Nominating and Governance Committee to consider nominees to our Board of Directors that are recommended by our common stockholders, but such nominees will be considered in accordance with the principal responsibilities of the Nominating and Governance Committee, our bylaws and all applicable rules and regulations relating to such nominations by our common stockholders. Please see our Questions and Answers beginning on page 5 for deadlines to propose actions for consideration at next year's annual meeting of stockholders or to nominate individuals to serve as directors. The Nominating and Governance Committee has the responsibility for developing criteria for the selection of new directors and nominees for vacancies. The members of the Nominating and Governance Committee have the

discretion to choose candidates that have the desired experience, mix of skills and other qualities to assure appropriate composition while taking into account the current members and the specific needs of our company and our Board of Directors. To date, no more specific criteria has been developed than that set forth in the charter. Furthermore, we have not had a common stockholder propose a nominee to our Board of Directors nor have we paid any third party a fee to assist us in the process of identifying or evaluating candidates for our Board of Directors. A copy of the Nominating and Governance Committee charter can be found on our website at [www.innovogroup.com](http://www.innovogroup.com) under our Investor Relations heading.

**Q: How are members of the Board of Directors compensated for their service?**

**A:** For fiscal 2005 and pursuant to our 2004 Stock Incentive Plan, each non-employee director received for his annual compensation a grant of options to purchase up to 50,000 shares of our common stock at an exercise price of \$5.91 per share. These options were vested in full on the date of grant and expire ten years from the date of grant. The exercise price was set at the fair market value of the common stock on the date of grant.

Members of our Board of Directors who are employees receive no additional compensation for service as members of our Board of Directors. Members of our Board of Directors who also serve on one or more committees of our Board of Directors do not receive any additional compensation for such service.

**Q: Has our Board of Directors adopted a code of ethics?**

**A:** Our Board of Directors adopted a Code of Business Conduct and Ethics for all of our directors, officers and employees on May 22, 2003. Our Code of Business Conduct and Ethics is available on our website at [www.innovogroup.com](http://www.innovogroup.com) or you may request a free copy of our Code of Business Conduct and Ethics from our Chief Compliance Officer at our corporate headquarters at the following address: 5804 East Slauson Avenue, Commerce, California 90040 or by calling (323) 725-5516. You may also find a copy of our Code of Business Conduct and Ethics as Exhibit 14 originally filed with our Annual Report on Form 10-K for the fiscal year ended November 29, 2003 with the SEC on February 28, 2004.

To date, there have been no waivers under our Code of Business Conduct and Ethics. We intend to disclose any amendments to our Code of Business Conduct and Ethics and any waiver granted from a provision of such Code on a Current Report on Form 8-K filed with the SEC within four business days following such amendment or waiver or on our website at [www.innovogroup.com](http://www.innovogroup.com) within the same time frame. The information contained or connected to our website is not incorporated by reference into this proxy statement and should not be considered a part of this or any other report that we file or furnish to the SEC.

**Q: Does our Board of Directors have a process for our common stockholders to communicate with its members?**

**A:** At the present time, our Board of Directors has not adopted a formal policy to set forth a process by which our common stockholders may communicate with its members. However, any communications directed to members of our Board of Directors will be given due consideration and will be handled in accordance with the principal responsibilities of various committees, the duties as a member of our Board of Directors, our bylaws and all applicable rules and regulations relating to communications by our common stockholders.

**PROPOSAL 2**

**APPROVAL OF THE SALE OF CERTAIN OF OUR ASSETS CONSISTING OF OUR PRIVATE LABEL APPAREL DIVISION**

Our Board of Directors has approved and recommended the sale of certain of our assets consisting of our private label apparel division pursuant to an asset purchase agreement by and among Cygne Designs, Inc., or Cygne, Innovo Azteca Apparel, Inc., or IAA, and Innovo Group Inc., or Innovo Group, dated as of March 31, 2006.

**Q: What is the Board of Directors recommending?**

**A:** The Board of Directors is asking the stockholders to authorize the sale to Cygne of certain assets of our private label apparel division, namely:

- the private label apparel division's customer list, which consists of American Eagle Outfitters, Inc., or AEO and Target Corporation, or Target;
- all existing purchase orders and inventory related to our private label apparel division; and
- the benefit of a non-compete clause with Azteca Production International, Inc., or Azteca in favor of us.

Cygne also agreed to hire our current workforce related to our private label apparel division. We will refer to this transaction as the Asset Sale. We executed an asset purchase agreement with Cygne to sell these assets on the terms described elsewhere in this proxy statement. **The Board unanimously recommends that you vote in favor of the proposal.** Azteca will be a party to certain ancillary agreements related to the asset purchase agreement because they are an interested party in the transaction. We recommend that you read carefully the complete asset purchase agreement for the terms and conditions of the sale and other information that may be important to you. The asset purchase agreement is included in this proxy statement as *Exhibit A*.

**Q: Why should the company sell its private label apparel assets to Cygne Designs?**

**A:** As described in greater detail in this proxy statement, our Board of Directors believes that it is in the best interest of the company and its stockholders to sell certain assets of to our private label apparel division to allow us to focus our resources on our Joe's Jeans® branded apparel line, which we believe has greater growth potential.

**Q: How do I know if the company is receiving fair value for the assets?**

**A:** Our Board of Directors' belief that the consideration to be received from Cygne for the Asset Sale is fair to us and our stockholders based on a variety of factors, including, but not limited to, the current financial condition and future net sales and prospects for our private label apparel division, the results of efforts by us to seek investment interest from other third parties, an evaluation of possible alternatives to the transaction, such as shutting down the business, and a fairness opinion delivered to our Board of Directors by The Mentor Group Inc., or The Mentor Group.

**Q: Will I, as a stockholder, have appraisal rights under Proposal 2?**

**A:** No. Under Delaware law, appraisal rights are not available in a sale or exchange of a company's assets.

**Q: What is the background for this transaction?**

**A:** We originally purchased the assets for our private label apparel division on July 17, 2003 through an asset purchase agreement, or the Blue Concept asset purchase agreement, with the Blue Concept Division of Azteca, Hubert Guez and his brother, Paul Guez, two of our stockholders and the principal owners of Azteca. See Related Party Transactions. Pursuant to the Blue Concept asset purchase agreement, we acquired the assets related to designing, manufacturing and wholesaling denim apparel to AEO, a national retailer. In addition, we agreed to employ all of the existing employees of the Blue Concept Division; however, we did not assume any of the liabilities. As payment of the purchase price, we issued a seven-year convertible promissory note for the full purchase price of \$21.8 million. On March 5, 2004, in accordance with the Blue Concept asset purchase agreement and Nasdaq rules, we held a special meeting of our stockholders to convert up to \$12.5 million of the debt into shares of our common stock. The conversion was approved by our stockholders and as a result, Azteca was issued 3,125,000 shares of our common stock at a conversion price of \$4.00 per share. Accordingly, the Blue Concept Note was reduced from \$21.8 million to \$9.3 million. We are also obligated to issue an additional 1,041,667 shares no later than June 10, 2006 as a result of the average stock price of our common stock being less than \$3.00 per share for the period between February 10, 2006 and March 12, 2006 under the terms of the Blue Concept asset purchase agreement. The Blue Concept Note accrued interest at a rate of 6%, required payment of interest only during the first 24 months and is being amortized over the remaining five-year period. A monthly payment of principal and interest in the amount of approximately \$180,000 commenced on August 5, 2005. As of May 12, 2006, the date of this annual meeting, the principal amount outstanding together with accrued interest is expected to be \$7,937,000. If Proposal 2 is approved and the closing occurs shortly thereafter, we expect that Cygne's assumption of our remaining liability under the Blue Concept Note will be this amount. We believed, at the time of the acquisition, that the Blue Concept Division would provide us with a revenue stream and operating profit necessary to sustain its operation.

**Q: Why did the Board of Directors decide to evaluate opportunities related to this asset?**

**A:** Throughout fiscal 2005, we monitored overall sales related to our private label apparel products and began to notice a decline in orders which we attributed to changes in our customers' sourcing strategy. During this same time period, we continued to experience overall net losses in our financial performance, in part, due to operating expenses associated with our private label apparel division. At the end of fiscal 2005, we evaluated several factors, including (i) our expected net sales from our existing private label apparel customers, (ii) the cost of operations related to our private label apparel division, and (iii) projected cash flows from operations. Based upon this evaluation, we realized that private label apparel sales would continue to decrease for us for the foreseeable future and we could not see the potential for us to continue in the private label apparel business without further investment. In addition, we realized that the fair value of our private label apparel business was not adequate to sustain the amount of goodwill allocated to this line of operation. As a result, we recognized a permanent impairment loss as part of operating income for fiscal 2005 and recorded an impairment charge of \$12,572,000 for goodwill related to our private label apparel business. This impairment charge resulted in a significant overall loss from continuing operations of \$16,429,000 for fiscal 2005. Rather than continue to invest in our private label apparel business, we believed that our best course of action was to focus our resources on assets which would offer greater growth potential, such as our Joe's Jeans® branded apparel line. For example from fiscal 2003 to fiscal 2005 we experienced significant growth in sales of our Joe's Jeans® products. Net sales of Joe's Jeans® grew from \$11,476,000 in fiscal 2003 to \$33,304,000 in fiscal 2005, a 190% increase.

**Q: Where can I find a summary of the transaction?**

**A:** Beginning on page 1, you can find a brief summary of the material terms of the Cygne transaction. This summary highlights selected information contained elsewhere in this proxy statement and may not contain all information that may be important to you. You should carefully read this entire proxy statement and the other documents referenced herein for a more complete understanding of the matters being considered at the annual meeting.

**Q: Who are the parties to the transaction?**

**A:** The parties to the asset purchase agreement are Cygne, IAA and us. Azteca is a party to certain ancillary agreements to the asset purchase agreement because they are an interested party. IAA is our wholly owned subsidiary and was a party to the original Blue Concept asset purchase agreement.

Cygne is a designer, merchandiser and manufacturer of branded and private label women's denim, casual, and career apparel with sales to retailers located in the United States. Cygne's principal executive offices are in New York, New York and it owns a manufacturing facility for the manufacture of non-denim private label garments in Guatemala. Cygne's major customers include New York & Company, Inc., JC Penney and Kohl's. Cygne's branded products are sold under the names Hippie, Hint and Manhattan Blues. On July 31, 2005, Cygne acquired certain assets of Diversified Apparel Resources, LLC (formerly named Commerce Clothing Company LLC), a limited liability company whose managing member and Chief Executive Officer is Hubert Guez, who is also one of our stockholders, a stockholder of Azteca and a party to the Blue Concept asset purchase agreement. Mr. Guez beneficially owns, has the power to dispose or direct the disposition, and to vote or direct the voting of shares, personally, through various trusts and Diversified, of approximately 49% of the shares of Cygne's common stock. Cygne's common stock is traded on the Nasdaq Capital Market under the symbol CYDS.

Azteca is a designer, wholesaler and contract manufacturer of branded and private label denim apparel based in Commerce, California. Azteca manufactures denim apparel through manufacturing facilities it owns in Mexico. The facility is operated by its wholly-owned subsidiary, AZT International S. de R.L. de C.V., or AZT. AZT has entered into non-exclusive supply agreements and arrangements with both us and Cygne in connection with the manufacture and supply of private label and branded denim apparel products. We originally purchased the private label apparel division from Azteca, Hubert Guez and Paul Guez in July 2003 as discussed in **Q: What is the background for this transaction?** above. Azteca is the beneficial owner of 13.06% of our common stock. Azteca is jointly owned by Hubert Guez and Paul Guez. Hubert Guez beneficially owns less than 5% of our common stock and Paul Guez beneficially owns 6.26% of our common stock. See **Related Party Transactions** and **Security Ownership of Certain Beneficial Owners and Management**.

**Q: What are the assets to be sold pursuant to the transaction?**

**A:** The assets to be sold to Cygne consist of certain assets of our private label apparel division, namely, the private label apparel division's customer list, all existing purchase orders and inventory related to our private label apparel division, and the benefit of a non-compete clause with Azteca in favor of us. Cygne has also agreed to hire our current workforce related to our private label division.

**Q: What assets will remain following the transaction?**

**A:** Following the transaction, assuming approval of Proposal 2, we will continue to own certain assets remaining from the private label apparel division, including certain account receivables and general business related assets, such as cash and cash equivalents and fixed assets, such as sewing machines, computers, equipment and other related physical property. Furthermore, we will continue to have all

the assets related to our Joe s Jeans® branded apparel line and expect to focus all of our efforts on operating this branded apparel line.

**Q: What is the purchase price for the transaction?**

**A:** In exchange for the purchased assets, Cygne has agreed to assume certain liabilities associated with our private label apparel division, namely, the remaining obligation under the original promissory note executed in favor of Azteca under the Blue Concept asset purchase agreement, the obligation to continue to pay the earn out royalty under the Blue Concept asset purchase agreement, all other liabilities, except for the original promissory note, that we may owe to Azteca in excess of \$1,500,000, and all liabilities associated with our outstanding purchase orders and inventory schedules listed in the asset purchase agreement, or the Assumed Liabilities. The aggregate value of the Assumed Liabilities, which represents the purchase price for the transaction, is approximately \$10,437,000 and is subject to certain adjustments related to the aggregate value of certain liabilities owed to Azteca as of the closing date and payment of certain audit related fees. No cash will be transferred in connection with this transaction. This purchase price was supported by a fairness opinion issued by The Mentor Group.

**Q: What are the material terms of the asset purchase agreement?**

**A:** The asset purchase agreement is attached to this proxy statement as *Exhibit A*. We encourage you to read the asset purchase agreement in its entirety, as it is the legal document that governs the Asset Sale. We refer you to page 28 of this proxy statement for a summary of the material terms of the asset purchase agreement. However, this summary should not replace a reading of the actual agreement and we recommend that you read carefully the asset purchase agreement for the terms of the transaction and other information that may be important to you.

**Q: What are the tax consequences of Proposal 2 to stockholders?**

**A:** The sale of the assets of the private label apparel division will not be taxable to our stockholders. See *The Proposed Asset Sale* Material U.S. Federal Income Tax Consequences.

**Q: When is the closing expected to occur?**

**A:** If Proposal 2 is approved and all conditions to completing the sale are satisfied or waived, the closing is expected to occur shortly after the annual meeting.

**Q: What is the vote required to approve Proposal 2?**

**A:** The affirmative **FOR** vote of a majority of our shares of common stock issued and outstanding and entitled to vote on the proposal is required to approve the sale of certain assets of our private label division to Cygne pursuant to the asset purchase agreement.

**Q: How does the Board of Directors recommend I vote?**

**A:** Our Board of Directors unanimously recommends a vote **FOR** the approval of the sale of certain assets of our private label apparel division to Cygne pursuant to the asset purchase agreement.

## THE PROPOSED ASSET SALE

*Capitalized terms used herein have been previously defined.*

### General

Under the asset purchase agreement, we have agreed to sell to Cygne certain assets of our private label apparel division in exchange for the assumption of certain liabilities, with an aggregate value of approximately \$10,437,000, subject to certain adjustments. The determination of the purchase price and the other terms and conditions of the asset purchase agreement are discussed below.

### Background of the Asset Sale

We originally purchased the assets of our private label apparel division on July 17, 2003 through an asset purchase agreement, previously defined as the Blue Concept asset purchase agreement, with the Blue Concept Division of Azteca, Hubert Guez and his brother, Paul Guez, two of our stockholders and the principal owners of Azteca. Pursuant to the Blue Concept asset purchase agreement, we acquired the assets related to designing, manufacturing and wholesaling denim apparel to AEO, a national retailer. In addition, we agreed to employ all of the existing employees of the Blue Concept Division; however, we did not assume any of the liabilities. As payment of the purchase price, we issued a seven-year convertible promissory note for the full purchase price of \$21.8 million. On March 5, 2004, in accordance with the Blue Concept asset purchase agreement and Nasdaq rules, we held a special meeting of our stockholders to approve the conversion of up to \$12.5 million of the debt into shares of our common stock. The conversion was approved by our stockholders and Azteca was issued 3,125,000 shares of our common stock at a conversion price of \$4.00 per share. As a result, the Blue Concept Note was reduced from \$21.8 million to \$9.3 million. We are also obligated to issue an additional 1,041,667 shares no later than June 10, 2006 as a result of the average stock price of our common stock being less than \$3.00 per share for the period between February 10, 2006 and March 12, 2006 under the terms of the Blue Concept asset purchase agreement. The Blue Concept Note accrued interest at a rate of 6%, required payment of interest only during the first 24 months and is being amortized over the remaining five-year period. A monthly payment of principal and interest in the amount of approximately \$180,000 commenced on August 5, 2005. As of May 12, 2006, the date of this annual meeting, the principal amount outstanding together with accrued interest is expected to be \$7,937,000. If Proposal 2 is approved and the closing occurs shortly thereafter, we expect that Cygne's assumption of our remaining liability under the Blue Concept Note will be this amount. We believed, at the time of the acquisition, that the Blue Concept Division would provide us with a revenue stream and operating profit necessary to sustain its operation.

Throughout fiscal 2005, we monitored overall sales related to our private label apparel products and began to notice a decline in orders which we attributed to changes in our customers' sourcing strategy. During this same time period, we continued to experience overall net losses in our financial performance, in part, due to operating expenses associated with our private label apparel division. At the end of fiscal 2005, we evaluated several factors, including (i) our expected net sales from our existing private label apparel customers, (ii) the cost of operations related to our private label apparel division, and (iii) projected cash flows from operations. We expected to see a decline in net sales of private label apparel products due to changes in customers' sourcing strategy to utilize suppliers other than us. Because we do not enter into long term contracts or firm order commitments with any of our customers, including our private label customers, a decision to utilize other suppliers for private label products could cause a decrease in sales, as we saw in the first quarter of fiscal 2006 with our 32% decrease in private label net sales. We believe that this trend will continue. Additionally, under our current purchase order arrangement with AZT for AEO orders, the purchase price on the products supplied for AEO provide for a fixed margin per unit of 15%. Due to the fixed margin arrangement with AZT for AEO orders, the primary way

for the private label apparel division to increase profits is to increase sales to customers other than AEO. We currently do not have the requisite sales force to allow us to compete for business with new customers.

Based upon this evaluation, we realized that private label apparel sales would continue to decrease for us for the foreseeable future without further investment by us and we could not see the potential for us in the private label apparel business. In addition, we realized that the fair value of our private label apparel business was not adequate to sustain the amount of goodwill allocated to this line of operation. As a result, we recognized a permanent impairment loss as part of operating income for fiscal 2005 and recorded an impairment charge of \$12,572,000 for goodwill related to our private label apparel business. This impairment charge resulted in a significant overall loss from continuing operations of \$16,429,000 for fiscal 2005. Rather than continue to invest in our private label apparel business, we believed that our best course of action was to focus our resources on assets which would offer greater growth potential, such as our Joe's Jeans® branded apparel line. For example from fiscal 2003 to fiscal 2005 we experienced significant growth in sales of our Joe's Jeans® products. Net sales of Joe's Jeans® grew from \$11,476,000 in fiscal 2003 to \$33,304,000 in fiscal 2005, a 190% increase.

In November 2005, we entered into a confidentiality agreement with Cygne, Diversified Apparel Resources LLC, or Diversified, AZT, Hubert Guez and Keyomars Fard. Mr. Guez, Mr. Fard, Diversified and AZT provide services to Cygne and therefore, were expected to be furnished with proprietary information during the course of the evaluation and due diligence process related to a possible strategic business relationship between us and Cygne. AZT also provides services to us pursuant to the original Blue Concept asset purchase agreement and supply and purchase order arrangements. The parties engaged in preliminary discussions regarding the form and structure related to a possible transaction related to our private label apparel division.

In November 2005, we entered into a confidential discussion about a possible transaction with a company affiliated with Paul Guez that was not pursued by either party. Due to the interrelationship between our private label apparel business, Azteca, and the Guez's, it seemed unlikely that a third party without a prior relationship with Azteca or the Guez's would be willing to purchase the assets of this division, since a portion of the purchase price would be used to pay off the original promissory note to Azteca, as well as the fact that we utilize AZT as the contract manufacturer for our private label apparel products. Cygne has such a relationship with AZT and Hubert Guez is Cygne's largest stockholder.

Management kept the Board of Directors apprised through informal communications of all discussions and developments related to a possible transaction for the private label apparel business. On January 10, 2006, management provided the Board of Directors with an update at a meeting and the Board of Directors discussed the possible sale of the private label apparel business to an entity owned by or affiliated with Mr. Hubert Guez. The Board of Directors recommended that an independent member of the Board of Directors be involved in the process related to a potential sale of the private label apparel business or further discussions with Mr. Guez or related companies to allow the process to be as objective as possible. The Board of Directors selected Mr. Kent Savage as its independent member to assist in this process. Mr. Crossman kept the Board of Directors, including Mr. Savage as the independent member, informed of his discussions throughout the process.

Discussions continued among management, Mr. Guez and Cygne's management about the possible transaction. On February 15, 2006, Mr. Crossman met with Mr. Bernard Manuel, Chief Executive Officer of Cygne, at Cygne's offices in New York City.

In late-February 2006, management delivered a draft of a non-binding letter of intent to the Board of Directors which outlined the proposal pursuant to which Cygne would acquire the assets related to the private label apparel division in exchange for the assumption of certain liabilities. Specifically, the letter of intent named the assets related to the private label apparel business to be acquired as: (i) the existing customer list, (ii) a mutually agreed upon number of employees, (iii) all existing purchase orders, (iv) all



work-in-progress, (v) all inventory identified by the parties, and (vi) the benefit of a non-compete clause with Azteca contained in the original Blue Concept asset purchase agreement in favor of us. The liabilities to be assumed were described as: (i) all remaining obligations under the promissory note from the original Blue Concept asset purchase agreement, (ii) the contingent liabilities of IAA identified and mutually agreed upon prior to closing, and (iii) all liabilities associated with the payment of an earn-out royalty under the Blue Concept asset purchase agreement.

On February 23, 2006, the Board of Directors met to discuss the terms of the non-binding letter of intent. After discussion and questions, the Board of Directors unanimously voted to approve the execution of the non-binding letter of intent upon the terms and conditions discussed and presented. On March 3, 2006, we executed the non-binding letter of intent with Cygne and Azteca as a consenting party due to the assumption by Cygne of certain of the provisions of the Blue Concept asset purchase agreement.

Shortly thereafter, management with the assistance of outside counsel drafted an asset purchase agreement and ancillary documents to reflect the terms of the non-binding letter of intent. On March 10, 2006, management circulated the initial draft of the asset purchase agreement and ancillary documents to Cygne and its counsel and Azteca and its counsel.

On March 29, 2006, management met with Cygne and Azteca at Diversified's offices in Los Angeles, California. Following that meeting, the parties agreed that most of the deal points had been resolved and that the draft of the asset purchase agreement and ancillary documents be amended to reflect the parties' agreement. Following that meeting, revised drafts of the asset purchase agreement and ancillary documents were circulated to the parties.

On March 30, 2006, our Board of Directors met to discuss the terms of asset purchase agreement. After due consideration and careful discussion and a review of the preliminary draft of the fairness opinion, our Board of Directors voted to authorize management to move forward with finalizing the asset purchase agreement and the ancillary documents under the terms and conditions discussed and presented to the Board of Directors by management.

On March 31, 2006, our Board of Directors acted through unanimous written consent to approve the asset purchase agreement and to authorize management to execute the asset purchase agreement and all ancillary documents necessary to carry out the intent of the resolutions. As of the same date, The Mentor Group delivered a written opinion as to the fairness of the Asset Sale to our stockholders from a financial point view. There were no material differences between the preliminary and final versions of the fairness opinion, except for adjustments related to the value of the Assumed Liabilities.

On March 31, 2006, we executed the definitive asset purchase agreement with Cygne.

#### **Our Reasons for the Asset Sale**

We entered into the asset purchase agreement after evaluating available alternatives to address our overall continued losses related to our financial performance. Based upon these and other considerations, we selected the Asset Sale as offering the best value to our stockholders.

In reaching this determination, our Board of Directors and management considered a number of factors:

- the absence of viable alternative offers;
- the amount and nature of the consideration to be received under the asset purchase agreement; including the ability to eliminate our promissory note to Azteca;
- our overall continuing operating losses and financial performance;

- the belief of our Board of Directors and management that the terms and conditions of the asset purchase agreement are reasonable; and
- a fairness opinion by The Mentor Group.

Our Board of Directors and management also identified and considered the following potentially negative factors concerning these assets:

- the risk that we may have to continue to operate our private label apparel business since the business represented a significant portion of our assets and under Delaware law, we believed that we could not dispose of or exit from it without stockholder approval;
- the risk that we may continue to have approximately \$7,937,000 in long-term debt outstanding and continue to make monthly payments in principal and interest to Azteca;
- the risk that our stockholders may not approve the transaction; and
- the other risks described in the **Risk Factors** section beginning on page 43.

After deliberations, our Board of Directors concluded that, on balance, the potential benefits of the Asset Sale to our stockholders outweighed these risks and potential disadvantages.

The foregoing discussion of the information and factors considered by our Board of Directors is not intended to be exhaustive, but includes the relevant factors considered. In reaching its decision to approve the Asset Sale and to recommend it to our stockholders, our Board of Directors did not view any single factor as determinative and did not find it necessary or relevant to assign any weight to each of the various factors considered. Individual directors may have given different weights to different factors.

#### **Recommendation of our Board of Directors**

Our Board of Directors believes that the terms of the Asset Sale are in the best interest of our stockholders and has approved the Asset Sale and the asset purchase agreement. Accordingly, our Board of Directors unanimously recommends that our stockholders vote **FOR** the approval of the Asset Sale pursuant to the asset purchase agreement.

#### **Fairness Opinion of our Financial Advisor**

We retained The Mentor Group to render an opinion with respect to the fairness, from a financial point of view, to us and our stockholders of the financial consideration to be received by us for the sale of the assets of our private label apparel division.

On March 31, 2006, The Mentor Group delivered its final written opinion to the effect that, based upon and in reliance on the matters described in its opinion, the financial consideration of approximately \$10,437,000, subject to certain adjustments, through the assumption of the Assumed Liabilities, was fair to us and our stockholders from a financial point of view as of the date of such opinion.

**The full text of The Mentor Group's opinion to our Board of Directors, which sets forth the assumptions made, matters considered, qualifications and extent of review by The Mentor Group is attached as *Exhibit B* and is incorporated herein by reference. Such opinion should be read carefully and in its entirety in conjunction with this proxy statement. The following summary of The Mentor Group is qualified in its entirety by reference to the full text of the opinion.**

The Mentor Group consented to the inclusion of its opinion and the inclusion of this summary in this proxy statement.

**The Mentor Group's opinion is addressed to our Board of Directors and does not constitute a recommendation to any of our stockholders as to how such stockholder should vote at the annual meeting described in this proxy statement.**

The terms associated with the Asset Sale were determined based on negotiations between us and Cygne and were not based on any recommendations by The Mentor Group. No limitations or instructions were imposed on The Mentor Group with respect to the investigations made or the procedures to follow in rendering its opinion.

In connection with rendering its opinion, The Mentor Group reviewed and analyzed, among other things, the following:

- the terms of the Asset Sale, including the asset purchase agreement;
- certain of our historical financial statements and other financial information;
- certain other information, primarily financial in nature, concerning our business and operations and our private label apparel business that we furnished to them;
- discussions with certain members of management, regarding, among other things, the business and prospects of us and our private label apparel business, operations, financial conditions, future prospects and projected operations and performance of the private label apparel business, certain forecasts and projections related to the business provided to them by us and pro forma allocations related to the private label apparel business;
- the historical trading price and volume of our common stock;
- performance of variance analysis on the underlying assumptions of growth and expenses.
- certain other publicly available financial data for certain companies that The Mentor Group deemed comparable to our private label apparel business, and publicly available prices paid in other transactions considered similar to this transaction; and
- such other matters as were deemed relevant.

The final written opinion was based upon certain business, economic, market, and other conditions that existed as of the date of such opinion. Based upon these considerations, The Mentor Group concluded that, in its opinion, the transaction was fair, from a financial point of view, to us and our current stockholders.

The methodologies used by The Mentor Group in arriving at its opinion were:

- the public company multiples method;
- merger/acquisitions multiples method;
- capitalization of historical income method; and
- discounted cash flow method.

Under the public companies multiples methods, stock sales related to seven similar industry represented public companies were analyzed to develop multiples of income statements and/or balance sheet statistics. The average and median indicated values under the public companies multiples method were \$6,090,000 to \$16,360,000.

Under the merger/acquisition multiples method, transactional sales greater than 50% of the ownership related to eleven similar industry represented public companies were analyzed to develop multiples of income statement and/or balance sheet statistics reflecting historical sales of going concerns. The median indicated value under the merger/acquisitions multiples method was \$6,900,000.



Under the capitalization of historical income method, the underlying concept is that the purchase of the private label apparel business is analogous to the making of an investment in an earnings generating asset. Accordingly, the value of such an investment is directly related to the amount of the earnings that can be generated by such property. First, the historical earnings of the private label apparel business was analyzed. Earnings before taxes, interest, depreciation and amortization, or EBITDA, was selected as best representative of industry standard for multiples and the earnings base least effected by the transaction. A rate of return was determined based on the capital asset pricing model and the weighted average cost of capital, or WACC. The selected multiples indicated a range of values under the capitalization of historical income method of approximately \$4,848,000 to \$6,014,000.

Under the discounted cash flow method, current condition of the private label apparel and a projection of the future operations was analyzed to discount the present value of three years of cash flows. Based on key assumptions and other assumptions under the discounted cash flow method, a range of indicated values of \$4,200,000 to \$11,900,000 was presented.

The Mentor Group is a full service, national investment banking, financial advisory, valuation and appraisal firm. For its services, we paid The Mentor Group its customary fee of \$30,000 for such an opinion. The Mentor Group previously provided us with a fairness opinion with regard to the terms of our original acquisition of the Blue Concept Division from Azteca in July 2003. Therefore, we selected them again to prepare this fairness opinion because we believed that they were familiar with the original transaction and certain of the liabilities to be assumed by Cygne under the asset purchase agreement.

#### **Use of Proceeds**

At the closing, Cygne will assume and be responsible for all of the Assumed Liabilities, namely, the remaining obligation under the original promissory note executed in favor of Azteca under the Blue Concept asset purchase agreement, the obligation to continue to pay the earn out under the Blue Concept asset purchase agreement, all other liabilities, except for the liability under the original promissory note, that we may owe to Azteca in excess of \$1,500,000, and all liabilities associated with our outstanding purchase orders and inventory schedules listed in the asset purchase agreement. We will enter into an assignment and assumption agreement with Cygne at closing to effectuate this assignment of the benefit of the non-compete clause and the assumption of the Assumed Liabilities. No cash will be transferred in connection with this transaction.

#### **Our Business Following the Asset Sale**

Following the transaction, assuming approval of the Asset Sale by our stockholders, we will continue to have certain assets remaining from the private label apparel division, including certain account receivables and general business related assets, such as cash and cash equivalents and fixed assets, such as sewing machines, computers, equipment and other related physical property. Furthermore, we will continue to have all the assets related to our branded apparel division, primarily our Joe s Jeans® branded apparel line, and expect to focus all of our efforts on operating this branded apparel line.

We intend to capitalize on the growing Joe s Jeans® brand and solidify its position in the consumer marketplace. Since Joe s Jeans was established in 2001, the brand is recognized in the premium denim industry for its quality, fit and fashion-forward designs for denim and denim related apparel products. By focusing our resources on our Joe s Jeans® brand, we believe that we can position the brand as a resource for the fashion conscious consumer through the introduction of a women s sportswear lifestyle collection and the launch of a men s denim line, which had approximately \$180,000 in net sales for the first quarter of fiscal 2006. The ability for our Joe s Jeans® brand to be profitable relies, in part, on our ability to (i) continue to increase our overall net sales for Joe s, which grew 92% in the first quarter fiscal 2006 compared to the first quarter 2005, (ii) increase our gross margins, and (iii) improve the management of

our inventory. There can be no assurance that our refocused efforts on our Joe's Jeans® brand will result in overall profitability for us.

**Appraisal Rights**

Under Delaware law, appraisal and dissenters' rights are not provided to stockholders in connection with the Asset Sale.

**Material U.S. Federal Income Tax Considerations**

The proposed Asset Sale will be treated as a sale of corporate assets in exchange for the assumption of liabilities for the full purchase price.

The proposed Asset Sale will not have any taxable effect to our stockholders since there will not be any proceeds for distribution in the form of a dividend.

**Regulatory Approvals**

Except for compliance with applicable Delaware law and United States securities laws, no regulatory requirements must be complied with and no governmental approvals must be obtained in connection with the Asset Sale.

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## THE ASSET PURCHASE AGREEMENT

The following discussion is a summary of the material provisions of the asset purchase agreement. This summary and all other discussions of the terms and conditions of the asset purchase agreement included elsewhere in this proxy statement are qualified in their entirety by reference to the asset purchase agreement, a copy of which is attached as *Exhibit A* to this proxy statement and incorporated herein by reference. All stockholders are urged to read the asset purchase agreement carefully and in its entirety. Capitalized terms used but not defined in this proxy statement have the meaning set forth in the asset purchase agreement.

### Parties to the Asset Sale

**Seller.** Innovo Azteca Apparel, Inc. is a California corporation and the wholly owned subsidiary of Innovo Group Inc., a Delaware corporation. We design, develop and market denim and denim related apparel products. Prior to entering into this asset purchase agreement, our products consisted of Joe's Jeans® and providing private label apparel denim products for mass retailer customers, such as AEO and Target. Our principal office is located at 5804 East Slauson Avenue, Commerce, California 90040. Our main telephone number is (323) 725-5516.

**Buyer.** Cygne is a Delaware corporation and is a designer, merchandiser and manufacturer of branded and private label apparel women's denim, casual, and career apparel to retailers in the United States. Cygne's principal office is located at 11 West 42nd Street, New York, NY 10036. Its main telephone number is (212) 997-7767. Cygne acquired certain assets of Diversified Apparel Resources, LLC (formerly named Commerce Clothing Company LLC), a limited liability company whose managing member and Chief Executive Officer is Hubert Guez, who is also one of our stockholders, a stockholder of Azteca and a party to the Blue Concept asset purchase agreement that we originally entered into for our purchase of the private label apparel division from Azteca. Mr. Guez beneficially owns, has the power to dispose or direct the disposition of, and to vote or direct the voting of shares, personally, through various trusts and Diversified, approximately 49% of the shares of Cygne's common stock. Cygne's common stock is traded on the Nasdaq Capital Market under the symbol CYDS. Mr. Hubert Guez is a stockholder of our company and beneficially owns less than 5% of our common stock.

**Other Interested Parties.** Azteca is a California corporation and is a designer, wholesaler and contract manufacturer of branded and private label denim based in Commerce, California. Azteca manufactures denim apparel through manufacturing facilities it owns in Mexico. The facility is operated by its wholly-owned subsidiary, AZT International S. de R.L. de C.V., or AZT. AZT has entered into non-exclusive supply agreements and arrangements with both us and Cygne in connection with the manufacture and supply of each of private label and branded denim apparel products. We originally purchased the private label apparel division business from Azteca, Hubert Guez and Paul Guez in July 2003 as discussed in *Q: What is the background for this transaction?* above. Azteca is the beneficial owner of 13.06% of our common stock. Azteca is jointly owned by Hubert Guez and Paul Guez. Hubert Guez beneficially owns less than 5% of our common stock and Paul Guez beneficially owns 6.26% of our common stock. See *Related Party Transactions*.

### Assets to be Sold Pursuant to the Asset Purchase Agreement

The assets to be sold to Cygne pursuant to the asset purchase agreement consist of certain assets of our private label apparel division, namely:

- the private label apparel division's customer list;
- all existing purchase orders and inventory related to our private label apparel division; and
- the benefit of a non-compete clause with Azteca in favor of us.





Cygne has also agreed to hire the current workforce related to our private label apparel division.

#### **Purchase Price**

In exchange for the private label division assets, Cygne has agreed to assume certain liabilities associated with our private label apparel division, namely, the remaining obligation under the original promissory note executed in favor of Azteca under the Blue Concept asset purchase agreement, the obligations to continue to pay the earn out under the Blue Concept asset purchase agreement, all other liabilities, except for the liability under the original promissory note, that we may owe to Azteca in excess of \$1,500,000 and all liabilities associated with our outstanding purchase orders and inventory schedules listed in the asset purchase agreement, or the Assumed Liabilities. The aggregate value of the Assumed Liabilities, which represents the purchase price for the transaction, is approximately \$10,437,000, subject to certain adjustments related to the aggregate value of liabilities owed to Azteca as of the closing date and payment of certain audit related fees. No cash will be transferred in connection with this transaction.

#### **Retained Liabilities**

The asset purchase agreement states that other than the Assumed Liabilities, we will retain all other liabilities associated with the private label apparel division. Our other liabilities include some additional amounts owed to Azteca pursuant to certain supply arrangements we previously entered into with them for the supply of finished goods for products related to our Joe's Jeans® and indie product lines. In addition, we will continue to have certain assets remaining from the private label apparel division, including, certain account receivables and general business related assets, such as cash and cash equivalents and fixed assets, such as sewing machines, computers, equipment and other related physical property. Furthermore, we will continue to have all the assets related to our Joe's Jeans® branded apparel line and expect to focus all of our efforts on operating this line as our primary source of revenue.

#### **Representations and Warranties**

The asset purchase agreement contains representations and warranties made by each of us, including our IAA subsidiary, and Cygne to the other, certain of which are qualified in nature.

Cygne's representations and warranties relate to the following matters:

- corporate organization, existence, good standing and power to authority to conduct its business;
- corporate authority to enter into, carry out the obligations under the asset purchase agreement and enforceability of the asset purchase agreement against Cygne;
- absence of any breach or violation of any of Cygne's charter or bylaws, any breach of any contract, order or permit to which Cygne is a party or requires consent by any party;
- no payment of any finder's fee in connection with the execution of the asset purchase agreement;
- litigation matters;
- solvency; and
- completeness of the representations.

Our representation and warranties relate to the following matters, concerning ourselves and our IAA subsidiary, as well as the conduct of our private label apparel business:

- corporate organization, existence, good standing and power to authority to conduct its business;
- corporate authority to enter into, carry out the obligations under the asset purchase agreement and enforceability of the asset purchase agreement against us;



- absence of any breach or violation of any of our charter or bylaws, any breach of any contract, order or permit to which we are a party or requires consent by any party;
- no payment of any finder's fee in connection with the execution of the asset purchase agreement;
- financial statements regarding our private label apparel business;
- absence of certain changes since January 31, 2006 regarding our operation of our private label apparel business;
- compliance with all laws related to our operation of our private label apparel business;
- legal compliance;
- payment of taxes and other tax related matters;
- title to the purchased assets;
- intellectual property rights;
- enforceability of and absence of changes related to all material contracts related to our private label apparel business;
- the amount, enforceability and absence of changes or claims related to of our accepted and unfulfilled orders related to our private label apparel business;
- litigation matters;
- warranties related to the products we provide to our customers;
- employee and employee benefit matters;
- environmental, health and safety matters;
- customers and suppliers;
- permits;
- solvency;
- accuracy of disclosure of material information and representations;
- absence of certain illegal business practices;
- information related to disclosure in this proxy statement;
- opinion related to financial fairness of the transaction; and
- completeness of the representations.

**Pre-Closing Covenants**

Between March 31, 2006 and the earlier of the closing date or Termination Date, which is the earlier of June 30, 2006 or termination in accordance with the asset purchase agreement, the parties have agreed that:

- each party will use its best efforts to do all things to consummate the transaction and comply with all aspects of the asset purchase agreement; and
- obtain any and all consents or give all notices necessary to consummate the transaction.

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Further,