BLUEFLY INC
Form 10-Q
April 30, 2003

U.S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2003

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

Commission File Number: 001-14498

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

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

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

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

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

As of April 29, 2003, the issuer had outstanding 11,024,568 shares of Common Stock, $.01 par value.

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BLUEFLY, INC.

CONSOLIDATED CONDENSED BALANCE SHEETS

ASSETS	
Current assets	
Cash and cash equivalents	
Inventories, net	
Accounts receivable, net	
Prepaid expenses	
Other current assets	
Total current assets	
Property and equipment, net	
Other assets	
Total assets	

LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities
Accounts payable
Accrued expenses and other current liabilities
Deferred revenue

Total current liabilities

Note payable to shareholders
Long-term capital lease liability

Total liabilities

Commitments and contingencies

Shareholders' equity
Series A Preferred stock - $.01 par value; 500,000 shares authorized, 460,000 and 500,000 issued and outstanding as of March 31, 2003 and December 31, 2002, respectively (liquidation preference: $9.2 million plus accrued dividends)
Series B Preferred stock - $.01 par value; 9,000,000 shares authorized 8,889,414 and 8,910,782 shares issued and outstanding as of March 31, 2003 and December 31, 2002, respectively (liquidation preference: $30 million plus accrued dividends)
Series C Preferred stock - $.01 par value; 3,500 shares authorized and 1,000 shares issued and outstanding as of March 31, 2003 and December 31, 2002, respectively (liquidation preference: $1 million plus accrued dividends)
Series D Preferred stock - $.01 par value; 7,150 shares authorized, issued and outstanding as of March 31, 2003 (liquidation preference: $7.1 million plus accrued dividends); no shares authorized, issued and outstanding as of December 31, 2002
Series 2002 Convertible Preferred stock - $.01 par value; 2,100 shares authorized and 0 and 2,100 shares issued and outstanding as of March 31, 2003 and December 31, 2002, respectively (liquidation preference: $2.1 million)
Common stock - $.01 par value; 40,000,000 shares authorized and 11,024,568 and 10,391,904 share issued and outstanding as of March 31, 2003 and December 31, 2002, respectively
Additional paid-in capital
Accumulated deficit

Total shareholders' equity

Total liabilities and shareholders' equity

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

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BLUEFLY, INC.
CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS
(Unaudited)

	THREE MONTHS ENDED MARCH 31,	
	2003	2002

Net sales	$ 8,257,000	$ 7,646,000
Cost of sales	6,400,000	5,146,000
Gross profit	1,857,000	2,500,000
Selling, marketing and fulfillment expenses	2,453,000	2,436,000
General and administrative expenses	1,162,000	1,062,000
Total	3,615,000	3,498,000
Operating loss	(1,758,000)	(998,000)
Interest income	6,000	32,000
Interest expense	(88,000)	(99,000)
Net loss	$ (1,840,000)	$ (1,065,000)
Deemed dividend related to beneficial conversion feature on Series C Preferred Stock	(225,000)	--
Preferred stock dividends	(638,000)	(609,000)
Net loss applicable to common shareholders	$ (2,703,000)	$ (1,674,000)
Basic and diluted loss per common share	$ (0.25)	$ (0.18)
Weighted average common shares outstanding (basic and diluted)	10,982,390	9,205,331

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

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

	THREE M MA 2003
Cash flows from operating activities	
Net loss	$ (1,840,00
Adjustments to reconcile net loss to net cash used in operating activities:	
Depreciation and amortization	402,00
Provisions for returns	(421,00
Allowance for doubtful accounts	50,00
Write-down (recovery) of inventory	12,00
Changes in operating assets and liabilities:	
(Increase) decrease in	

Inventories	191,00
Accounts receivable	(108,00
Prepaid expenses	1,00
Other current assets	(15,00
Other assets	-
Increase (decrease) in	
Accounts payable	91,00
Accrued expenses and other current liabilities	(705,00
Deferred revenue	160,00
Net cash used in operating activities	(2,182,00
Cash flows from investing activities	
Purchase of property, equipment and capitalized software	(44,00
Net cash used in investing activities	(44,00
Cash flows from financing activities	
Proceeds from sale of Notes Payable (January 2003 Financing)	1,000,00
Proceeds from sale of Series D Preferred Stock	2,000,00
Payments of capital lease obligation	(47,00
Net cash provided by financing activities	2,953,00
Net increase (decrease) in cash and cash equivalents	727,00
Cash and cash equivalents - beginning of period	1,749,00
Cash and cash equivalents - end of period	$ 2,476,00
Supplemental schedule of non-cash investing and financing activities:	
Repayment of note and reallocation of proceeds to equity	$ 2,027,00
Conversion of debt to equity	$ 1,009,00
Deemed dividend related to beneficial conversion feature on Series C Preferred Stock	$ 225,00
Warrants issued to shareholders	$ 43,00
Interest paid	$ 15,00
Warrant issued to factor	$ -

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

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BLUEFLY, INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
MARCH 31, 2003

NOTE 1 - BASIS OF PRESENTATION

The accompanying consolidated financial statements include the accounts of Bluefly, Inc. and its wholly owned subsidiary (collectively the "Company"). All significant intercompany balances and transactions have been eliminated in consolidation. The consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnote disclosures required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The results of operations of any interim period are not necessarily indicative of the results of operations to be expected for the fiscal year. For further information, refer to the consolidated financial statements and accompanying footnotes included in the Company's Form 10-K for the year ended December 31, 2002.

The Company has sustained net losses and negative cash flows from operations since the establishment of Bluefly.com. The Company's ability to meet its obligations in the ordinary course of business is dependent on its ability to establish profitable operations and/or raise additional financing through public or private debt or equity financing, or other sources to fund operations. The Company currently plans to seek additional equity or debt financing in order to maximize the growth of its business. There can be no assurance that any additional financing or other sources of capital will be available to the Company on acceptable terms, or at all. The inability to obtain additional financing, when needed, would have a material adverse effect on the Company's business, prospects, financial condition and results of operations. The Company believes that cash and cash equivalents on hand at March 31, 2003 together with the 2003 Standby Commitment (defined below) and the Loan Facility (defined below) will be sufficient to fund operations through December 31, 2003. If the Company is unable to obtain additional financing, and/or the Company does not achieve its sales plan, future operations will need to be modified, scaled back or discontinued.

NOTE 2 - THE COMPANY

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

NOTE 3 - SOROS FINANCINGS

JANUARY 2003 FINANCING

In January 2003 the Company issued to Quantum Industrial Partners LDC, a Cayman Islands limited duration company ("QIP"), and SFM Domestic Investments LLC, a Delaware limited liability company ("SFMDI;" QIP and SFMDI are each affiliates of Soros Private Equity Partners LLC and are collectively and individually sometimes referred to herein as "Soros") $1.0 million of demand convertible promissory notes that bore interest at a rate of 8% per annum and had a maturity date of July 28, 2003 ("January 2003 Financing") and warrants to purchase 25,000 shares of its common stock, exercisable at any time on or prior to January 28, 2007 at $1.12 per share. These notes were converted into Series D Convertible Preferred Stock ("Series D Preferred Stock") in connection with the March 2003 Financing (defined below).

The Company valued the warrants issued in the January 2003 Financing using the Black-Scholes option pricing model and credited additional paid in capital for approximately $21,000. This entire amount was expensed as interest expense during the first quarter of 2003.

MARCH 2003 FINANCING

In March 2003, the Company entered into an agreement with Soros pursuant to which Soros: (i) provided $2.0 million of new capital by purchasing 2,000 shares of Series D Preferred Stock, (ii) converted the promissory notes issued to it in the January 2003 Financing and all of its Series 2002 Preferred Stock into 3,109.425 shares of Series D Preferred Stock and (iii) purchased 2,027.123 additional shares of Series D Preferred Stock for approximately $2.0 million, with such $2.0 million in additional proceeds being retained by Soros as payment in full of the Company's obligations under the demand promissory notes issued to Soros in September 2002 (the "March 2003 Financing").

Each share of Series D Preferred Stock has a face value of $1,000 and a liquidation preference equal to the greater of (i) $1,000 plus accrued and unpaid dividends or (ii) the amount the holder of such shares would receive if it were to convert such shares into Common Stock immediately prior to the liquidation of the Company. The Series D Preferred Stock is convertible, at any time and from time to time at the option of the holder into Common Stock at the rate of one to 1,315.79. The conversion price of the Series D Preferred Stock is subject to an anti-dilution adjustment, pursuant to which, subject to certain exceptions, to the extent that the Company issues Common Stock or securities convertible into Common Stock at a price per share less than the Series D Preferred Stock conversion price in the future, the conversion price of the Series D Preferred Stock would be decreased so that it would equal the conversion price of the new security or the price at which shares of common stock are sold, as the case may be. However, to the extent required by the rules of the Nasdaq SmallCap Market or any other national securities exchange or quotation system upon which the Common Stock may be listed from time to time, until such time as such conversion provisions are approved by the Company's stockholders, the total number of shares of Common Stock issuable upon conversion of the Series D Preferred Stock may not exceed 2,204,803 shares (which represents approximately 19.99% of the Company's currently outstanding Common Stock), regardless of any adjustment to the Series D Preferred Stock conversion price.

Beginning on November 13, 2004, the Company is entitled to redeem all, but not less than all, of the outstanding Series D Preferred Stock for cash at the price of, depending upon the date of such redemption, four times, four and one-half times or five times the market price of the Common Stock on the date of the initial issuance of the Series D Preferred Stock. Dividends accrue on the Series D Preferred Stock at an annual rate equal to 12% of the face value and are payable only upon the conversion or redemption of the Series D Preferred Stock or upon liquidation of the Company. The Series D Preferred Stock votes on an as converted basis, except with respect to approval of the conversion provisions of the Series D Preferred Stock or any equity securities issued in connection with the funding of the 2003 Standby Commitment Amount, as defined below.

Additionally, Soros agreed to provide the Company with up to $1.0 million in additional financing (the "2003 Standby Commitment Amount") on a standby basis at any time prior to January 1, 2004, provided that the Company's cash balances are less than $1.0 million (the "2003 Standby Commitment.") Such financing can be made in one or more tranches as determined by the members of the Company's Board of Directors who are not Soros designees, and any and all draws against the 2003 Standby Commitment Amount shall be effected through the purchase of newly-designated shares of Series E Preferred Stock on terms and conditions substantially identical to the Series D Preferred Stock, except that: (1) the conversion price of the Series E Preferred Stock will be the lower of (a) the average closing price of the Common Stock on the Nasdaq SmallCap Market for the ten trading days preceding the issuance of the Series E Preferred Stock and (b)

$0.76; and (2) the Series E Preferred Stock will not be convertible into Common Stock (and will not be entitled to vote with the Common Stock on matters submitted to a vote of the holders of the Common Stock) until such time as the Company's stockholders approve the conversion rights of the Series E Preferred Stock to the extent required by the rules of the Nasdaq SmallCap Market or any other national securities exchange or quotation system upon which the Common Stock may be listed from time to time. Subject to certain limitations, the 2003 Standby Commitment Amount shall be reduced on a dollar-for-dollar basis by the gross cash proceeds received by the Company or any of its subsidiaries from the issuance of any equity or convertible securities after March 12, 2003. To the extent that a draw down on the 2003 Standby Commitment Amount results in the conversion price of the Series E Preferred Stock being less than $0.76, Soros has agreed to waive its right to readjust the conversion price on the Series B, C and D Preferred Stock in connection with the issuance of the Series E Preferred Stock.

As a result of the March 2003 Financing, the conversion price of the Series B Preferred Stock and the Series C Preferred Stock, all of which is held by Soros, automatically decreased from $0.93 to $0.76 per share. In accordance with EITF 00-27, the reduction in the conversion price of the Series C Preferred Stock resulted in the Company recording a beneficial conversion feature in the approximate amount of $225,000. This non-cash charge, which is analogous to a dividend, resulted in an adjustment to the Company's computation of Loss Per Share, in the first quarter of 2003.

NOTE 4 - FINANCING AGREEMENT

The Company has a Financing Agreement (the "Financing Agreement") with Rosenthal & Rosenthal, Inc. ("Rosenthal") pursuant to which Rosenthal provides the Company with certain credit accommodations, including loans and advances, factor-to-factor guarantees or letters of credit in favor of suppliers or factors or purchases of payables owed to the Company's suppliers (the "Loan Facility").

The Financing Agreement was amended in March 2003 to: (i) extend the term until June 30, 2004; (ii) increase the maximum amount available under the Loan Facility (subject to an existing $10 million cap) to an amount equal to the Soros Guarantee ($2.0 million) plus the lower of (x) $2.0 million (instead of the prior $1.0 million), (y) 20% of the book value of the Company's inventory or (z) the full liquidation value of the Company's inventory; (iii) increase the tangible net worth requirement to $5.0 million from $1.5 million; (iv) redefine the working capital definition to exclude short-term debt held by affiliates (effective as of December 19, 2002), (v) increase the working capital requirement to $4.0 million from $3.5 million; (vi) increase the annual fee the Company pays Rosenthal for the Loan Facility to $30,000 from $10,000, (vii) require the Company to maintain a cash balance of at least $250,000 and; (viii) require Soros to increase from $1.5 million to $2.0 million the amount of the standby letter of credit that Soros is maintaining (the "Soros Guarantee") to help collateralize the Loan Facility and extend the term of the Soros Guarantee to November 15, 2004 from November 15, 2003. In consideration for Soros' agreement to maintain the Soros Guarantee until November 15, 2004, the Company issued to Soros a warrant to purchase 25,000 shares of its Common Stock at an exercise price equal to $0.78 per share (the 10 day trailing average of the closing sale price of our Common Stock on the date of issuance), exercisable at any time prior to March 17, 2013. The Company valued the warrant using the

Black-Scholes option pricing model and credited additional paid in capital for approximately $22,000. This amount is being amortized over the life of the Loan Facility.

As of March 31, 2003, after giving effect to the amendment, the maximum availability under the Loan Facility was approximately $3.9 million of which approximately $2.1 million was committed, leaving approximately $1.8 million available against the Loan Facility.

NOTE 5 - LOSS PER SHARE

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

Diluted loss per share is computed by dividing loss available to common shareholders by the weighted average number of common shares outstanding for the period, adjusted to reflect potentially dilutive securities. Due to the loss from continuing operations, the following options and warrants to purchase shares of Common Stock and Preferred Stock convertible into shares of Common Stock were not included in the computation of diluted loss per share because the result of the exercise of such inclusion would be antidilutive:

Security	March 31, 2003	March 31, 2002
Options	9,570,412	3,859,578
Warrants	1,119,144	1,069,144
Preferred Stock	42,057,813	13,184,286

NOTE 6 - STOCK BASED COMPENSATION

The Company applies Statement of Financial Accounting Standards No. ("SFAS") No. 148 "Accounting for Stock Based Compensation - Transition and Disclosure, an amendment of FASB Statement No. 123", SFAS No. 123 "Accounting for Stock Based Compensation," and FASB Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation"

("FIN 44") in accounting for its stock based compensation plan. In accordance with SFAS No. 123, the Company applies Accounting Principles Board ("APB") Opinion No. 25 and related Interpretations for expense recognition. In connection with stock option grants to employees, no compensation expense has been recorded in fiscal quarters ended 2003 and 2002, because the exercise price of employee stock options equals or exceeds the market price of the underlying stock on the date of grant. Had compensation expense for the Plan been determined consistent with the provisions of SFAS No. 123, the effect on the Company's basic and diluted net loss per share would have been as follows:

	March 31, 2003	March 31, 2002

Basic and diluted net loss, as reported	$	(1,840,000)	$	(1,065,000)
Basic and diluted net loss per share, as reported	$	(0.25)	$	(0.18)
Basic and diluted net loss, pro forma	$	(2,914,000)	$	(2,015,000)
Basic and diluted net loss per share, pro forma	$	(0.34)	$	(0.29)

The effects of applying SFAS No. 123 in this pro forma disclosure are not indicative of future amounts, as additional stock option awards are anticipated in future years.

NOTE 7 - RECLASSIFICATIONS

Certain amounts in the consolidated condensed financial statements of the prior period have been reclassified to conform to the current period presentation for comparative purposes.

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

OVERVIEW

Bluefly, Inc. is a leading Internet retailer of designer fashions and home accessories at outlet store prices. We sell over 350 brands of designer apparel, accessories and home products at discounts up to 75% off retail value. Bluefly.com, a Web Site that sells end-of-season and excess inventory of apparel and accessories was launched in September 1998.

We have grown significantly since launching our Web Site in September 1998. Our net sales increased approximately 8% to $8,257,000 for the three months ended March 31, 2003 from $7,646,000 for the three months ended March 31, 2002. Our net loss for the first quarter of 2003 totaled $1,840,000 compared to $1,065,000 in the first quarter of 2002.

At March 31, 2003 we had an accumulated deficit of $87,807,000. Historical net losses and the accumulated deficit resulted primarily from costs associated with developing and marketing our Web Site and building our infrastructure and the recording of beneficial conversion feature charges.

In order to expand our business, we intend to invest in sales, marketing, merchandising, operations, information systems, site development and additional personnel to support these activities. We therefore expect to continue to incur substantial operating losses for the foreseeable future. Although we have experienced revenue growth in recent years, this growth may not be sustainable and therefore should not be considered indicative of future performance.

Based on our current plans, we anticipate that the proceeds from the March 2003 Financing, the 2003 Standby Commitment and the Rosenthal Loan Facility together with existing resources, should be sufficient to satisfy our cash requirements through the end of fiscal 2003. We currently plan to seek additional debt and/or equity financing in order to maximize the growth of our business. There can be no assurance that any additional financing or other sources of capital will be available to us upon acceptable terms, or at all. The inability to obtain additional financing would have a material adverse effect on our business, prospects, financial condition and results of operations. If we are unable to obtain additional financing, and/or we do not achieve our sales plan, future operations will need to be modified, scaled back or discontinued.

In March 2003, we were advised by the Nasdaq Stock Market, Inc. ("Nasdaq") that we were no longer in compliance with Nasdaq's continued listing requirements (the "Listing Requirements") because shares of our common stock have closed at a per share price of less than $1.00 for at least 30 days and that, if we are unable to achieve compliance with the Listing Requirements by September 8, 2003, the Nasdaq Staff will determine whether we meet the initial listing criteria of the Nasdaq SmallCap Market. In the event that we meet such initial listing criteria, we will be granted an additional 180-day grace period to regain compliance. In order to regain compliance, shares of our common stock would need to close at a price of $1.00 or more for at least ten consecutive trading days. In the event that we do not regain compliance within the requisite time period, we intend to appeal any delisting. However, no assurance can be provided that any such appeal will be successful. The failure to maintain listing on the Nasdaq SmallCap Market may have an adverse effect on the price and/or liquidity of our common stock.

SIGNIFICANT ACCOUNTING POLICIES

Management Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. The most significant estimates and assumptions relate to the adequacy of the allowances for returns and recoverability of inventories. Actual amounts could differ significantly from these estimates.

Revenue Recognition

Gross sales consist primarily of revenue from product sales and shipping and handling revenue on our Web site, and is net of promotional discounts. Revenue is recognized when goods are received by our customers, which occurs only after credit card authorization. Net sales represent gross sales, less provisions for returns, credit card chargebacks, and adjustments for uncollected sales taxes.

Provision for Returns and Doubtful Accounts

We generally permit returns for any reason within 90 days of the sale. Accordingly, we establish a reserve for estimated future returns and bad debt at the time of shipment based primarily on historical data. However, our future return and bad debt rates could differ significantly from historical patterns, which would adversely affect our operating results.

Inventory Valuation

Inventories, which consist of finished goods, are stated at the lower of cost or market value. Cost is determined by the first-in, first-out ("FIFO") method. We review our inventory levels in order to identify slow-moving merchandise and use markdowns to clear out merchandise. Markdowns may be used if inventory exceeds customer demand for reasons of style, changes in customer preference or lack of consumer acceptance of certain items, or if it is determined that the inventory in stock will not sell at its currently marked price. Such markdowns may have an adverse impact on earnings, depending on the extent of the markdowns and amount of inventory affected.

Deferred Tax Valuation Allowance

We assessed the future taxable income and have determined that a 100% deferred tax valuation allowance is deemed necessary. In the event that we were to determine that we would be able to realize our deferred tax asset, an adjustment to the deferred tax valuation allowance would increase income in the period such determination is made.

RESULTS OF OPERATIONS

For The Three Months Ended March 31, 2003 Compared To The Three Months Ended March 31, 2002

The following table sets forth our statement of operations data, for the three months ended March 31st. All data in is in thousands except as indicated below:

	2003		2002		
		As a % of Net Sales		As a % of Net Sales	
Net sales	$ 8,257	100.0%	$ 7,646	100.0%	$
Cost of sales	6,400	77.5%	5,146	67.3%	
Gross profit	1,857	22.5%	2,500	32.7%	
Selling, marketing and fulfillment expenses	2,453	29.7%	2,436	31.9%	
General and administrative expenses	1,162	14.1%	1,062	13.9%	
Total operating expenses	3,615	43.8%	3,498	45.8%	
Operating loss	(1,758)	(21.3)%	(998)	(13.1)%	
Interest (expense) and other income	(82)	(1.0)%	(67)	(0.9)%	
Net loss	(1,840)	(22.3)%	(1,065)	(13.9)%	

We also measure and evaluate ourselves against certain other key operational metrics. The following table sets forth our actual results based on these other metrics for the three months ended March 31st, as indicated below:

	2003	2002
Average Order Size (including shipping & handling)	$ 167.20	$ 161.7
Average Order Size Per New Customer (including shipping & handling)	$ 153.01	$ 144.7
Average Order Size Per Repeat Customer (including shipping & handling)	$ 175.18	$ 171.5
New Customers Added during the Period	27,031	24,87
Revenue from Repeat Customers as a % of total Revenue	67%	6
Customer Acquisition Costs	$ 5.26	$ 9.4

We define a "repeat customer" as a person who has bought more than once from us during their lifetime. We calculate customer acquisition cost by dividing total advertising expenditures (excluding staff related costs) during a given time period by total new customers added during that period. All measures of the number of customers are based on unique email addresses.

Net sales: Gross sales for the three months ended March 31, 2003 increased by approximately 15% to $13,044,000, from $11,342,000 for the three months ended March 31, 2002. For the three months ended March 31, 2003, we recorded a provision for returns and credit card chargebacks and other discounts of $4,787,000, or approximately 36.7% of gross sales. For the three months ended March 31, 2002, the provision for returns and credit card chargebacks and other discounts was $3,696,000, or approximately 32.6% of gross sales. The increase in this provision as a percentage of gross sales was related primarily to an increase in the return rate. We believe that the increase in return rate was primarily the result of an increase in average order sizes.

After the necessary provisions for returns, credit card chargebacks and adjustments for uncollected sales taxes, our net sales for the three months ended March 31, 2003 were $8,257,000. This represents an increase of approximately 8% compared to the three months ended March 31, 2002, in which net sales totaled $7,646,000. The growth in net sales was largely driven by the increase in the number of new customers acquired (approximately 9% compared to first quarter 2002) and the increase in average order size.

Cost of sales: Cost of sales consists of the cost of product sold to customers, in-bound and out-bound shipping costs, inventory reserves, commissions and packing materials. Cost of sales for the three months ended March 31, 2003 totaled $6,400,000,

resulting in gross margin of approximately 22.5%. Cost of sales for the three months ended March 31, 2002 totaled $5,146,000, resulting in gross margin of 32.7%. Gross profit decreased by 26%, to $1,857,000 for the three months ended March 31, 2003 compared to $2,500,000 for the three months ended March 31, 2002. The decrease in gross margin resulted primarily from our decision to reduce our product margin on fall and winter merchandise in order to sell as much of the inventory as possible.

Selling, marketing and fulfillment expenses: Selling, marketing and fulfillment expenses increased by approximately 1% in the first three months of 2003 compared to the first three months of 2002. As a percentage of net sales, our selling, marketing and fulfillment expenses decreased to 29.7% in the first three months of 2003 from 31.9% in the first three months of 2002. The decrease in selling, marketing and fulfillment expenses as a percentage of net sales resulted primarily from a shift toward more performance based marketing programs including cost per new customer deals and commission based agreements and the cost savings we derived from our move to a new web hosting facility. Selling, marketing and fulfillment expenses were comprised of the following:

	Three Months Ended March 31, 2003	Three Months Ended March 31, 2002	Percentage Difference increase (decrease)
Marketing	$ 260,000	$ 346,000	(24.9%)
Operating	1,167,000	1,051,000	11.0%
Technology	724,000	769,000	(5.9%)

E-Commerce	302,000	270,000	11.9%
	$ 2,453,000	$ 2,436,000	0.7%

Marketing expenses include expenses related to online and print advertising, direct mail campaigns as well as staff related costs. The decrease in marketing expenses of approximately 24.9% was largely related to a shift in our customer acquisition strategy. We reduced our advertising expenditures and focused more on email, affiliate programs and other performance based programs. Primarily as a result of this shift, we were able to decrease our customer acquisition costs for the three months ended March 31, 2003 by approximately 44% to $5.26 per customer from $9.40 per customer for the three months ended March 31, 2002. However, in the event that we attempt to accelerate revenue growth, it may be necessary to utilize less cost efficient methods of customer acquisition, and accordingly there can be no assurance that customer acquisition costs will not increase in the future.

Operating expenses include all costs related to inventory management, fulfillment, customer service, and credit card processing. Operating expenses increased in the first three months of 2003 by approximately 11% compared to the first three months of 2002 as a result of variable costs associated with the increased sales volume (e.g., picking and packing orders, processing returns and credit card fees).

Technology expenses consist primarily of staff related costs, amortization of capitalized costs and Web Site hosting. For the three months ended March 31, 2003 technology expenses decreased by approximately 5.9% compared to the three months ended March 31, 2002. This decrease was related to a reduction in our Web Site hosting costs in connection with our move to a new web hosting facility and was partially offset by increased amortization expense incurred as a result of capital costs incurred in with the upgraded version of the Web Site.

E-Commerce expenses include expenses related to our photo studio, image processing, and Web Site design. For the three months ended March 31, 2003, this amount increased by approximately 11.9% as compared to the three months ended March 31, 2002, primarily due to the creation of an Online Retail Group within the E-Commerce department. The total headcount in the E-Commerce group increased to 17 during the first quarter of 2003 compared to 12 in the first quarter of 2002.

General and administrative expenses: General and administrative expenses include merchandising, finance and administrative salaries and related expenses, insurance costs, accounting and legal fees, depreciation and other office related expenses. General and administrative expenses for the three months ended March 31, 2003 increased by approximately 9.4% to $1,162,000 as compared to $1,062,000 for the three months ended March 31, 2002. The increase in general and administrative expenses was the result of increased professional services and salary and benefit expenses.

As a percentage of net sales, general and administrative expenses for the first quarter of 2003 remained relatively unchanged at approximately 14%.

Loss from operations: Operating loss increased by over 76% in the first three months of 2003 to $1,758,000 from $998,000 in the first three months of 2002 as a result of a decrease in gross margin.

Interest expense and other income, net: Interest expense for the three months ended March 31, 2003 totaled $88,000, and related to fees paid in connection with our Loan Facility as well as amortization of warrants issued in connection with the January 2003 Financing. For the three months ended March 31, 2002, interest expense totaled $99,000, and related primarily to fees paid in connection with the Loan Facility.

Interest income for the three months ended March 31, 2003 decreased to $6,000 from $32,000 for the three months ended March 31, 2002. The decrease is related to the decrease in our cash balance as interest income primarily represents interest earned on our cash balance.

LIQUIDITY AND CAPITAL RESOURCES

General

At March 31, 2003, we had approximately $2.5 million of liquid assets, entirely in the form of cash and cash equivalents, $1.0 available under the 2003 Standby Commitment and working capital of approximately $8.2 million. In addition, as of March 31, 2003, we had approximately $2.1 million of borrowings committed under the Loan Facility, leaving approximately $1.8 million of availability.

We fund our operations through cash on hand, operating cash flow and the Loan Facility, as well as the proceeds of any equity financing. Operating cash flow is affected by revenue and gross margin levels, and any deterioration in our performance on these financial measures would have a negative impact on our liquidity. Total availability under the Loan Facility is based upon our inventory levels and is dependent, among other things, on the Company having at least $5.0 million of tangible net worth and $4.0 million of working capital. In addition, both availability under the Loan Facility and our operating cash flows are affected by the payment terms that we receive from suppliers and service providers, and the extent to which suppliers require us to request Rosenthal to provide credit support under the Loan Facility. We believe that our suppliers' decision-making with respect to payment terms and/or the type of credit support requested is largely driven by their perception of our credit rating, which is affected by information reported in the industry and financial press and elsewhere as to our financial strength. Accordingly, negative perceptions as to our financial strength could have a negative impact on our liquidity.

Loan Facility

Pursuant to the Loan Facility, Rosenthal provides us with certain credit accommodations, including loans and advances, factor-to-factor guarantees, letters of credit in favor of suppliers or factors and purchases of payables owed to our suppliers. The Rosenthal Financing Agreement was amended in March 2003 to: (i) extend the term until June 30, 2004; (ii) increase the maximum amount available under the Loan Facility (subject to an existing $10 million cap) to an amount equal to the Soros Guarantee plus the lower of (x) $2.0 million (instead of the prior $1.0 million), (y) 20% of the book value of our inventory or (z) the full liquidation value of our inventory; (iii) increase the tangible net worth requirement to $5.0 million from $1.5 million; (iv) redefine the working capital definition to exclude short-term debt held by affiliates (effective as of December 19, 2002), (v) increase the working capital requirement to $4.0 million from $3.5 million; (vi) increase the annual fee we pay Rosenthal for the Loan Facility to $30,000 from $10,000, (vii) require us to maintain a cash balance of at least $250,000 and; (viii) require Soros to increase from $1.5 million to $2.0 million the amount of the standby letter of credit that Soros is maintaining to help secure the Loan Facility and extend the term of the Soros Guarantee to November 15, 2004 from November 15, 2003. In consideration for Soros' agreement to increase the amount of and to maintain the Soros Guarantee until November 15, 2004, we issued to Soros a warrant to purchase 25,000 shares of our Common Stock at an exercise price equal to $0.78 per share (the 10 day trailing average of the closing sale price of our Common Stock on the date of issuance), exercisable at any time prior to March 17, 2013.

Interest accrues monthly on the average daily amount outstanding under the Loan Facility during the preceding month at a per annum rate equal to the prime rate plus 1%. In addition to the annual facility fee of $30,000, we also pay Rosenthal certain fees to open letters of credit and guarantees in an amount equal to a certain percentage of the face amount of the letter of credit for each thirty (30) days such letter of credit, or a portion thereof, remains open.

In consideration for the Loan Facility, among other things, we granted to Rosenthal a first priority lien on substantially all of our assets, including control of all of our cash accounts upon an event of default and certain of our cash accounts in the event that the total amount of monies loaned to us under the Loan Facility exceeds 90% of the maximum amount available under the Loan Facility for more than 10 days. We also issued to Rosenthal a warrant to purchase 50,000 shares of Common Stock at an exercise price of $2.34, exercisable, as amended, for six years from the date of issuance.

Subject to certain conditions, if we default on any of our obligations under the Loan Facility, Rosenthal has the right to draw upon the Soros Guarantee to satisfy any such obligations. If and when Rosenthal draws on the Soros Guarantee, pursuant to the terms of the Reimbursement Agreement, we would have the obligation to, among other things, reimburse Soros for any amounts drawn under the Soros Guarantee plus interest accrued thereon. In addition, to the extent that Rosenthal draws on the Soros Guarantee during the continuance of a default under Loan Facility or at any time that the total amount outstanding under the Loan Facility exceeds 90% of the Soros Guarantee, we will be required to issue to Soros a warrant (each a "Contingent Warrant") to purchase a number of shares of Common Stock equal to the quotient of (a) any amounts drawn under the Soros Guarantee and (b) 75% of the average of the closing price of our Common Stock on the ten days preceding the date of issuance of such warrant. Each Contingent Warrant will be exercisable for ten years from the date of issuance at an exercise price equal to 75% of the average closing price of our Common Stock on the ten days preceding the ten days after the date of issuance.

Under the terms of the Loan Facility, Soros has the right to purchase all of our obligations from Rosenthal at any time during its term (the "Buyout Option"). With respect to such Buyout Option, Soros has the right to request that Rosenthal make a draw under the Soros Guarantee as consideration to Soros for the purchase of such obligations.

Commitments And Long Term Obligations

As of March 31, 2003, we had the following commitments and long term obligations:

	2003	2004	2005	2006	2007
Marketing and Advertising	$ 315,000	--	--	--	
Operating Leases	322,000	437,000	443,000	450,000	452,0
Capital Leases	143,000	190,000	67,000	--	
Employment Contracts	890,000	1,160,000	391,000	--	

Notes payable to shareholders	--	--	182,000	--	
Grand total	$ 1,670,000	1,787,000	1,083,000	450,000	452,0

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

In order to continue to expand our product offerings, we intend to expand our relationships with suppliers of end-of-season and excess name brand apparel and fashion accessories. We expect that our suppliers will continue to include designers and retail stores that sell excess inventory as well as third-party end-of-season apparel aggregators. To achieve our goal of offering a wide selection of top name brand designer clothing and fashion accessories, we may acquire certain goods on consignment and may explore leasing or partnering select departments with strategic partners and distributors. Due to our limited working capital, a number of our suppliers have limited our payment terms and, in some cases, have required us to pay for merchandise in advance of delivery.

We anticipate that the proceeds from the March 2003 Financing, the Loan Facility and the 2003 Standby Commitment, together with existing resources should be sufficient to satisfy our cash requirements through the end of fiscal 2003. However, we may seek additional debt and/or equity financing in order to maximize the growth of our business. There can be no assurance that any additional financing or other sources of capital will be available to us upon acceptable terms, or at all. The inability to obtain additional financing, if needed, would have a material adverse effect on our business, financial condition and results of operations.

RECENT ACCOUNTING PRONOUNCEMENTS

In July 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." SFAS No. 146 addresses the accounting and reporting for costs associated with exit or disposal activities and nullifies EITF No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." SFAS No. 146 requires that a liability for a cost associated with an exit or disposal activity be recognized at fair market value when the liability is incurred, rather than upon an entity's commitment to an exit plan, as prescribed by EITF No. 94-3. SFAS No. 146 is effective for exit and disposal activities initiated after December 31, 2002. We adopted SFAS No. 146 on January 1, 2003.

In November 2002, the FASB issued FASB Interpretation No. ("FIN") 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." FIN 45 elaborates on the disclosure requirements of a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also requires a guarantor to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing certain guarantees. FIN 45 also incorporates, without change, the guidance in FIN 34, "Disclosure of Indirect Guarantees of Indebtedness of Others," which it supersedes. The incremental disclosure requirements of FIN 45 are effective for financial statements of interim or annual periods ending after December 15, 2002. The initial recognition and initial measurement provisions are applicable to guarantees issued or modified after December 31, 2002. The accounting followed by a guarantor on prior guarantees may not be changed to conform to the guidance of FIN 45. We do not believe that the adoption of FIN 45 will have a material impact on our consolidated financial statements.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure, an amendment of FASB Statement No. 123." SFAS No. 148 amends SFAS No. 123, "Accounting for Stock-Based Compensation," to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. SFAS No. 148 is effective for fiscal years and interim periods beginning after December 15, 2002. We continue to account for stock-based employee compensation under the intrinsic value method of APB 25, "Accounting for Stock Issued to Employees." We adopted the disclosure provisions of SFAS No. 148 for the year ended December 31, 2002.

In January 2003, the FASB issued FIN 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51". FIN 46 requires an investor to consolidate a variable interest entity if it is determined that the investor is a primary beneficiary of that entity, subject to the criteria set forth in FIN 46. Assets, liabilities, and non controlling interests of newly consolidated variable interest entities will be initially measured at fair value. After initial measurement, the consolidated variable interest entity will be accounted for under the guidance provided by Accounting Research Bulletin No. 51, "Consolidated Financial Statements." FIN 46 is effective for variable interest entities created or entered into after January 31, 2003. For variable interest entities created or acquired before February 1, 2003, FIN 46 applies in the first fiscal year or interim period beginning after June 15, 2003. We do not believe that the adoption of FIN 46 will have a material impact on our consolidated financial statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

SPECIAL NOTE REGARDING FORWARD LOOKING STATEMENTS

BLUEFLY, INC.
MARCH 31, 2003

This report may include statements that constitute "forward-looking" statements, usually containing the words "believe", "project", "expect", or similar expressions. These statements are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements inherently involve risks and uncertainties that could cause actual results to differ materially from the forward-looking statements. The risks and uncertainties are detailed from time to time in reports filed by the company with the Securities and Exchange Commission, including Forms 8-A, 8-K, 10-Q, and 10-K. These risks and uncertainties include, but are not limited to, the following: the Company's limited working capital, need for additional capital and potential inability to raise such capital; recent losses and anticipated future losses; the risk that favorable trends in sales, repeat customer sales, average order size, and customer acquisition costs will not continue; risks that the Company will be unable to reduce the levels of losses; potential adverse effects on gross margin and gross profit resulting from mark downs and allowances; potential dilution arising from future equity financings, including potential dilution as a result of the anti-dilution provisions contained in the Company's Series B Preferred Stock, the Series C Preferred Stock and the Series D Preferred Stock; the competitive nature of the business and the potential for competitors with greater resources to enter such business; adverse trends in the retail apparel market; risks and uncertainties associated with the Company's recent launch of a new version of its web site, including new internal procedures that need to be developed to operate the new web site, site instability and download performance issues; risks of litigation for sale of unauthentic or damaged goods and litigation risks related to sales in foreign countries; availability formulas under the Rosenthal credit facility which limit the amount of funds available for borrowing; the Company's potential inability to make repayments under the Rosenthal credit facility and the possible shareholder dilution that could result if the Soros standby letter of credit is drawn upon; the risk of default by the Company under the Rosenthal financing agreement and the consequences that might arise from the Company having granted a lien on substantially all of its assets under that agreement; the dependence on third parties and certain relationships for certain services, including the Company's dependence on U.P.S. (and the risks of a mail slowdown due to terrorist activity) and the Company's dependence on its third-party web hosting and fulfillment centers; risks related to consumer acceptance of the Internet as a medium for purchasing apparel; the successful hiring and retaining of personnel; the dependence on continued growth of online commerce; rapid technological change; online commerce security risks; the startup nature of the Internet business; governmental regulation and legal uncertainties; management of potential growth; and unexpected changes in fashion trends.

ITEM 4. CONTROLS AND DISCLOSURES.

Within the 90 days prior to the date of this Form 10-Q, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's President and Chief Executive Officer along with the Company's Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Exchange Act Rule 13a-14. Based upon that evaluation, the Company's President and Chief Executive Officer along with the Company's Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective in timely alerting them to material information relating to the Company (including its consolidated subsidiaries) required to be included in the Company's periodic SEC filings. There have been no significant changes in the Company's internal controls or in other factors which could significantly affect internal controls subsequent to the date the Company carried out its evaluation.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

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

EXHIBIT NUMBER	DESCRIPTION
99.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant Sarbanes-Oxley Act of 2002
99.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant Sarbanes-Oxley Act of 2002

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BLUEFLY, INC.
MARCH 31, 2003

(b) Reports on Form 8-K:

Form 8K filed on April 29, 2003, attaching the Press Release announcing the Company's first quarter results.

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BLUEFLY, INC.
MARCH 31, 2003

SIGNATURES

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

BLUEFLY, INC.

By: /s/ E. Kenneth Seiff

E. Kenneth Seiff
CEO and President

By: /s/ Patrick C. Barry

Patrick C. Barry
Chief Financial Officer

April 29, 2003

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BLUEFLY, INC.
MARCH 31, 2003

CERTIFICATION

I, E. Kenneth Seiff, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Bluefly, Inc;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a. designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b. evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c. presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):

a. all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date April 29, 2003

/s/ E. Kenneth Seiff

E. Kenneth Seiff
Chief Executive Officer

BLUEFLY, INC.
MARCH 31, 2003

CERTIFICATION

I, Patrick C. Barry, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Bluefly, Inc;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a. designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b. evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c. presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):

a. all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date April 29, 2003

/s/ Patrick C. Barry

Patrick C. Barry
Chief Financial Officer