BLUEFLY INC
Form 10-Q
November 10, 2004

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

FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2004

[ ] TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ______ to ______

Commission File Number: 001-14498

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

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

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

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

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

As of November 5, 2004, the issuer had outstanding 14,788,675 shares of Common Stock, $.01 par value.

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PART I - FINANCIAL INFORMATION

ITEM 1. - FINANCIAL STATEMENTS

BLUEFLY, INC.
CONSOLIDATED CONDENSED BALANCE SHEETS
(Unaudited)

	SEPTEMBER 30, 2004
ASSETS	
Current assets	
Cash and cash equivalents	$ 7,370,000
Restricted cash	1,256,000
Inventories, net	10,666,000
Accounts receivable, net of allowance for doubtful accounts	1,174,000
Prepaid expenses	292,000
Other current assets	573,000
Total current assets	21,331,000

Property and equipment, net		1,596,000
Other assets		404,000
Total assets	$	23,331,000

LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities		
Accounts payable	$	3,175,000
Accrued expenses and other current liabilities		2,846,000
Deferred revenue		1,677,000
Notes payable to related party shareholders, includes interest payable of $574,000 as of September 30, 2004 and $34,000 as of December 31, 2003		4,756,000
Total current liabilities		12,454,000
Note payable to related party shareholders		--
Long-term interest payable to related party shareholders		--
Long-term capital lease liability		68,000
Total liabilities		12,522,000
Commitments and contingencies		
Shareholders' equity		
Series A Preferred stock - $.01 par value; 500,000 shares authorized, 460,000 issued and outstanding (liquidation preference: $9.2 million plus accrued dividends of $4.7 million and $4.0 million as of September 30, 2004 and December 31, 2003, respectively)		5,000
Series B Preferred stock - $.01 par value; 9,000,000 shares authorized, 8,889,414 shares issued and outstanding (liquidation preference: $30 million plus accrued dividends of $6.8 million and $5.2 million as of September 30, 2004 and December 31, 2003, respectively)		89,000
Series C Preferred stock - $.01 par value; 3,500 shares authorized and 1,000 shares issued and outstanding (liquidation preference: $1 million plus accrued dividends of $167,000 and $102,000 as of September 30, 2004 and December 31, 2003, respectively)		--
Series D Preferred stock - $.01 par value; 7,150 shares authorized, 7,136.548 issued and outstanding (liquidation preference: $7.1 million plus accrued dividends of $1.4 million and $678,000 as of September 30, 2004 and December 31, 2003, respectively)		--
Series E Preferred stock - $.01 par value; 1,000 shares authorized, issued and outstanding (liquidation preference: $1.0 million plus accrued dividends of $169,000 and $74,000 as of September 30, 2004 and December 31, 2003, respectively)		--
Common stock - $.01 par value; 92,000,000 shares authorized and 14,662,590 and 12,894,166 shares issued and outstanding as of September 30, 2004 and December 31, 2003, respectively		147,000
Additional paid-in capital		106,702,000
Accumulated deficit		(96,134,000)
Total shareholders' equity		10,809,000
Total liabilities and shareholders' equity	$	23,331,000

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

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

	NINE MONTH SEPTEMB
	2004
Net sales	$ 29,284,000
Cost of sales	18,729,000
Gross profit	10,555,000
Selling, marketing and fulfillment expenses	9,718,000
General and administrative expenses	4,896,000
Total operating expenses	14,614,000
Operating loss	(4,059,000)
Interest and other income	815,000
Interest expense	(554,000)
Net loss	$ (3,798,000)
Deemed dividend related to beneficial conversion feature on Series C Preferred Stock	--
Preferred stock dividends	(3,176,000)
Net loss available to common shareholders	$ (6,974,000)
Basic and diluted loss per common share	$ (0.48)
Weighted average common shares outstanding (basic and diluted)	14,508,692

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

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

	THREE MONT SEPTEMB
	2004

Net sales	$	8,675,000
Cost of sales		5,709,000
Gross profit		2,966,000
Selling, marketing and fulfillment expenses		3,059,000
General and administrative expenses		1,743,000
Total operating expenses		4,802,000
Operating loss		(1,836,000)
Interest and other income		30,000
Interest expense		(154,000)
Net loss	$	(1,960,000)
Preferred stock dividends		(1,090,000)
Net loss available to common shareholders	$	(3,050,000)
Basic and diluted loss per common share	$	(0.21)
Weighted average common shares outstanding (basic and diluted)		14,634,625

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

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

	NINE MONTH SEPTEMBE	
	2004	
Cash flows from operating activities		
Net loss	$	(3,798,000)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization		1,119,000
Non-cash expense related to warrants issued to supplier		194,000
Provisions for returns		(968,000)
Allowance for doubtful accounts		162,000
Reserve for inventory obsolescence		100,000
Change in value of warrants		(564,000)
Stock option expense		123,000
Changes in operating assets and liabilities:		
(Increase) decrease in		
Inventories		380,000
Accounts receivable		(179,000)
Prepaid expenses		(39,000)
Other current assets		(120,000)
Increase (decrease) in		

Accounts payable	53,000
Accrued expenses and other current liabilities	17,000
Interest payable to related party	381,000
Deferred revenue	425,000
Net cash used in operating activities	(2,714,000)
Cash flows from investing activities	
Cash collateral in connection with Rosenthal Pledge Agreement	(1,256,000)
Purchase of property and equipment	(891,000)
Net cash used in investing activities	(2,147,000)
Cash flows from financing activities	
Net proceeds from January 2004 Financing	4,577,000
Net proceeds from exercise of stock options	192,000
Proceeds from sale of Series D Preferred Stock	--
Proceeds from issuance of Notes Payable (July 2003 Financing)	--
Proceeds from issuance of Notes Payable (January 2003 Financing)	--
Proceeds from sale of Series E Preferred Stock	--
Payments of capital lease obligation	(259,000)
Net cash provided by financing activities	4,510,000
Net increase in cash and cash equivalents	(351,000)
Cash and cash equivalents - beginning of period	7,721,000
Cash and cash equivalents - end of period	$ 7,370,000
Supplemental schedule of non-cash investing and financing activities:	
Equipment acquired under capital lease	$ 153,000
Exchange of note for equity	--
Conversion of debt to equity	--
Deemed dividend related to beneficial conversion feature on Series C Preferred Stock	--
Warrants issued to related party shareholders	--
Interest paid	$ 121,000

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

BLUEFLY, INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
SEPTEMBER 30, 2004

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/A for the year ended December 31, 2003.

The Company has sustained net losses and negative cash flows from operations since the formation of Bluefly.com. The Company's ability to meet its obligations in the ordinary course of business is dependent on its ability to establish profitable operations and/or raise additional financing through public or private debt or equity financing, or other sources to fund operations. The Company believes that its current funds, together with working capital, will be sufficient to enable it to meet its planned expenditures through at least December 31, 2004. The Company may seek additional equity or debt financing to maximize the growth of its business or if anticipated operating results are not achieved. If such financings are not available on terms acceptable to the Company, and/or the Company does not achieve its operating plan, future operations will need to be modified, scaled back or discontinued.

NOTE 2 - THE COMPANY

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

NOTE 3 - JANUARY 2004 FINANCING

On January 12, 2004, the Company completed a private placement pursuant to which it raised $5,000,000. Under the terms of the deal, the Company issued 1,543,209 shares of Common Stock at $3.24 per share, which was 90% of the trailing five-day average of the Company's volume-weighted stock price as of December 29, 2003, the date that a preliminary agreement was reached as to the pricing of the deal. The Company also issued to the new investors warrants to purchase 385,801 shares of Common Stock at any time during the next five years at an exercise price equal to $3.96 per share. After professional fees and finders fees paid to brokers, the net proceeds from the transaction were approximately $4,577,000.

In accordance with EITF 00-19, the Company accounted for the warrants issued in January 2004 at fair market value and classified the warrants as a liability because the Company may be required to make cash payments to the investors who purchased the warrants in the event that the registration statement covering the offer and sale of the shares underlying the warrants were to no longer be effective. The Company used the Black-Scholes option pricing method (assumption: volatility 147%, risk free rate 3.76%, two year expected life and zero dividend yield) to calculate the value of the warrants. At January 12, 2004, the date of the transaction (the "Transaction Date"), the warrants had a value of $1,096,000. The value of the warrants was marked to market in each subsequent reporting period as a derivative gain or loss until June 17, 2004 (the "End Date"), at which time EITF 00-19 called for the warrants to be re-classified as equity because the maximum potential cash amount payable to the investors had decreased to the point where it was no longer considered significant.

During the period beginning on the Transaction Date and ending on the End Date, the value of the warrants decreased from $1,096,000 to $532,000, and, accordingly the Company recognized $564,000 of other income for the nine months ended September 30, 2004.

In January 2004, the Company also extended the maturity dates on the Convertible Promissory Notes issued to affiliates of Soros Private Equity Partners, LLC that collectively own a majority of its capital stock (collectively, "Soros") in July and October 2003 (the "Notes"). The maturity dates of the Notes, which were originally January and April 2004, respectively, were

each extended to March 1,2005. In February 2004, the maturity date of the Notes was further extended to May 1, 2005.

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 April 2004 to: (i) extend the term until March 30, 2005; (ii) substitute $1.25 million of cash collateral pledged by the Company for the $2.0 million standby letter of credit previously provided by Soros as collateral security for the Company's obligations under the Loan Facility; (iii) decrease the maximum amount available under the Loan Facility from $4.5 million to $4.0 million; (iv) increase the tangible net worth requirement to $7.0 million; (v) increase the working capital requirement to $6.0 million; and (vi) increase the minimum cash balance that the Company is required to maintain to $750,000 (exclusive of the $1.25 million in cash collateral). The cash collateral is included on the balance sheet as "Restricted Cash" and represents monies deposited in a segregated account that has been pledged to Rosenthal as collateral for the facility.

As of September 30, 2004, the maximum availability under the Loan Facility was approximately $3.5 million of which approximately $2.5 million was committed, leaving approximately $1.0 million available under 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	September 30, 2004	Exercise Prices	September 30, 2003
Options	10,071,023	$0.69 - $16.60	10,370,912
Warrants	1,704,945	$0.78 - $ 9.08	1,119,144
Preferred Stock	43,323,430*		43,323,430*
Convertible Notes**	--		--

* Excludes dividends on preferred stock, which are payable in cash or common stock, at the Company's option, upon conversion, redemption or liquidation.
** Represents debt issued in connection with the July 2003 financing and October 2003 financing, which is convertible into equity securities of the Company sold in any subsequent round of financing, at the holder's option, at a price that is equal to the lowest price per share accepted by any investor in such subsequent round of financing. Until such financing occurs, such debt is not convertible into Common Stock.

BLUEFLY, INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
SEPTEMBER 30, 2004

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" in accounting for its stock based compensation plan. In accordance with SFAS No. 123, the Company applies Accounting Principles Board Opinion No. 25 and related Interpretations for expense recognition. In the nine months ended September 30, 2004, compensation expense of $10,000 was recorded in connection with certain options issued below market value to the Company's Chief Executive Officer in accordance with the terms of her employment agreement, and $113,000 in compensation expense was recorded in connection with certain options issued to the Company's former Chief Executive Officer pursuant to his separation agreement. Except for these options, no compensation expense has been recorded in the nine months ended September 30, 2004 and September 30, 2003 in connection with stock option grants to employees, 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:

	For the Nine Months Ended		For the Three Mo	
	September 30, 2004	September 30, 2003	September 30, 2004	S
Net loss available to common shareholders	$ (6,974,000)	$ (9,059,000)	$ (3,050,000)	$
Add: Stock-based employee compensation expense included in reported net income	123,000	--	121,000	
Deduct: total stock-based employee compensation expense determined under				

fair value based method for all awards	(2,328,000)	(3,206,000)	(1,094,000)	
Pro forma, net loss available to common shareholders	(9,179,000)	(12,265,000)	(4,023,000)	
Loss Per Share:				
Basic and diluted, as reported	$ (0.48)	$ (0.82)	$ (0.21)	$
Basic and diluted, pro forma	$ (0.63)	$ (1.11)	$ (0.27)	$

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 - OTHER INCOME

In June 2002, the Company entered into an agreement with a third party investor pursuant to which the investor committed to purchase approximately $7 million of Common Stock and warrants from the Company. The investor breached the contract by failing to consummate the investment, although it did provide the Company with $169,000 as a good faith deposit. In October 2002, the Company filed an action against the investor based on its failure to consummate the investment, and in December 2003, the court entered judgment in the Company's favor against the third party investor in the amount of $3,793,688. In the first quarter of 2004, following the expiration of all applicable appeal periods, the Company recognized the good faith deposit of $169,000 as other income, as a partial recognition of litigation settlement. Based on the information currently available to it regarding the investor's finances, the Company does not believe that it will be successful in collecting a material amount of additional funds as a result of the damages award.

In addition, as discussed in Note 3 above, the Company recognized $564,000 of other income for the nine months ended

September 30, 2004 to adjust a liability associated with warrants issued by the Company to its fair value as of June 17, 2004 (at which point the liability was reclassified as equity in accordance with EITF 00-19 and described in Note 3).

NOTE 8 - 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., a Delaware corporation, is a leading Internet retailer that sells over 350 brands of designer apparel, accessories and home products at discounts up to 75% off retail value. Bluefly.com, our Web site, was launched in September 1998. Although we do not have permanent brick and mortar stores, we operated a temporary store in the New York city area during the 2003 holiday season and intend to do so again this year.

Our net sales increased approximately 6% to $8,675,000 for the three months ended September 30, 2004 from $8,210,000 for the three months ended September 30, 2003. For the nine months ended September 30, 2004, our net sales increased approximately 22% to approximately $29,284,000 from $23,935,000 for the nine months ended September 30, 2003.

Our gross margin increased to 34.2% in the third quarter of 2004 from 21.3% in the third quarter of 2003. For the nine months ended September 30, 2004, our gross margin increased to 36.0% from 24.7% for the nine months ended September 30, 2003. Our gross margin is dependent upon a number of factors, including our ability to forecast demand and fashion trends accurately, and, accordingly, there can be no assurance that we will meet any particular margin level.

Our customer acquisition costs decreased to $8.41 per customer in the third quarter of 2004, from $10.52 per customer in the third quarter of 2003. For the nine months ended September 30, 2004, customer acquisition costs were $10.04 per customer, as compared to $10.05 per customer for the nine months ended September 30, 2003. On average, the positive contribution to overhead that we generate from a customer's first purchase exceeds our current customer acquisition costs by a significant margin. Accordingly, we believe that it may be prudent to be more aggressive in acquiring customers (even though it may increase our customer acquisition costs for the remainder of 2004 and beyond) in order to acquire larger numbers of customers with profitable ordering patterns.

Our reserve for returns and credit card chargebacks decreased to 37.2% in the third quarter of 2004 from 39.5% in the third quarter of 2003. The reserve was 38% for the nine month periods ended September 30, 2004 and 2003. On the whole, our reserve for returns and credit card chargebacks has risen for the past few years, from 32% in 2001, to 36% in 2002 to 37% in 2003 as a result of increasing return rates. The increase in return rates has primarily been driven by shifts in our merchandise mix. However, we believe that the increase in return rates is more than offset by higher gross margins and average order sizes that have been generated by this shift in merchandise mix. While we continue to test smaller changes to our merchandise mix as well as improvements to our product descriptions and packaging in order to reduce our return rates, which may have had some impact on the decrease in return rates during the third quarter of this year, we believe that the overall shift in merchandise mix has been beneficial to the overall gross profit realized per order. Accordingly, we do not know whether the recent trend towards decreasing return rates will continue.

From time to time, a portion of our inventory consists of out-of-season merchandise that we either purchased with the intention of holding for the appropriate season or were unable to sell in a prior season and have determined to hold for the next selling season, subject (in some cases) to appropriate mark-downs.

At September 30, 2004, we had an accumulated deficit of $96,134,000, of which approximately $29,000,000 was the result of non-cash beneficial conversion charges incurred in connection with the reduction of the conversion price of the Company's Preferred Stock. The net losses and accumulated deficit resulted primarily from the costs associated with developing and

marketing our Web site and building our infrastructure. 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 near 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.

CRITICAL 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 sales returns, the recoverability of inventories and deferred tax valuation allowances. Actual amounts could differ significantly from these estimates.

Revenue Recognition

We recognize revenue in accordance with Staff Accounting Bulletin ("SAB") No. 101 "Revenue Recognition in the Financial Statements" as amended. Gross sales consists primarily of revenue from product sales and shipping and handling charges and is net of promotional discounts. Net sales represent gross sales, less provisions for returns, credit card chargebacks, and adjustments for uncollected sales taxes. Revenue is recognized when all the following criteria are met:

- A customer executes an order.
- The product price and the shipping and handling fee have been determined.
- Credit card authorization has occurred and collection is reasonably assured.
- The product has been shipped and received by the customer.

Shipping and handling billed to customers are classified as revenue in accordance with Financial Accounting Standards Board ("FASB") Task Force's Emerging Issues Task Force ("EITF") No. 00-10, "Accounting for Shipping and Handling Fees and Costs" ("EITF No. 00-10").

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. We perform credit card authorizations and check the verification of our customers prior to shipment of merchandise. However, our future return and bad debt rates could differ from historical patterns, and, to the extent that these rates increase significantly, it could have a material adverse effect on our business, prospects, cash flows, financial condition and results of operations.

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 establish a reserve for such merchandise.

Deferred Tax Valuation Allowance

We recognize deferred income tax assets and liabilities on the differences between the financial statement and tax bases of assets and liabilities using enacted statutory rates in effect for the years in which the differences are expected to reverse. The effect on

deferred taxes of a change in tax rates is realized in income in the period that included the enactment date. We have assessed the future taxable income and 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 assets, an adjustment to the deferred tax valuation allowance would increase income in the period such determination is made.

RESULTS OF OPERATIONS

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2004 COMPARED TO THE NINE MONTHS ENDED SEPTEMBER 30, 2003

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

	2004		2003		
		As a % of Net Sales		As a % of Net Sales	
Net sales	$ 29,284	100.0%	$ 23,935	100.0%	$ 2
Cost of sales	18,729	64.0%	18,015	75.3%	1
Gross profit	10,555	36.0%	5,920	24.7%	
Selling, marketing and fulfillment expenses	9,718	33.2%	8,277	34.6%	
General and administrative expenses	4,896	16.7%	3,883	16.2%	
Total operating expenses	14,614	49.9%	12,160	50.8%	1
Operating loss	(4,059)	(13.9)%	(6,240)	(26.1)%	(
Interest expense and (other income)	261	0.9%	(240)	(1.0)%	
Net loss	(3,798)	(13.0)%	(6,480)	(27.1)%	(

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 nine months ended September 30th, as indicated below:

	2004	2003
Average Order Size (including shipping & handling)	$ 185.83	$ 168.03
Average Order Size Per New Customer (including shipping & handling)	$ 162.02	$ 153.37

Average Order Size Per Repeat Customer (including shipping & handling)	$ 198.83	$ 176.10
New Customers Added during the Period	84,605	79,134
Revenue from Repeat Customers as a % of total Revenue	70%	68
Customer Acquisition Costs	$ 10.04	$ 10.0

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 (which includes sales of product and shipping revenue) for the nine months ended September 30, 2004 increased by over 22% to $47,188,000, from $38,612,000 for the nine months ended September 30, 2003. For the nine months ended September 30, 2004, we recorded a provision for returns and credit card chargebacks and other discounts of $17,904,000, or approximately 38% of gross sales. For the nine months ended September 30, 2003, the provision for returns and credit card chargebacks and other discounts was $14,677,000, or approximately 38% of gross sales.

After the necessary provisions for returns, credit card chargebacks and adjustments for uncollected sales taxes, our net sales for the nine months ended September 30, 2004 were $29,284,000. This represents an increase of approximately 22% compared to the nine months ended September 30, 2003, in which net sales totaled $23,935,000. The growth in net sales resulted from both the net revenue from new customers acquired and an increase in average order size (approximately 11% higher compared to the nine months ended September 2003). For the nine months ended September 30, 2004 revenue from shipping and handling (which is included in net sales) increased by almost 23% to $2,320,000 from $1,892,000 for the nine months ended September 30, 2003. Shipping and handling revenue increased at a slightly higher rate than revenue as a whole because we have not offered as many free shipping promotions in 2004, although this effect has been partially offset by an 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 nine months ended September 30, 2004 totaled $18,729,000, resulting in gross margin of approximately 36.0%. Cost of sales for the nine months ended September 30, 2003 totaled $18,015,000, resulting in gross margin of 24.7%. Gross profit increased by approximately 78%, to $10,555,000 for the nine months ended September 30, 2004 compared to $5,920,000 for the nine months ended September 30, 2003. The growth in gross margin is primarily the result of increased product margins. Our gross margins were lower in 2003 than they had been historically because we decided to turn more of our out-of-season merchandise, as well as inventory items that we were particularly deep in, into cash that could be used to purchase new inventory, rather than holding the inventory for the next season. Because we currently have significantly more cash than we did during a large part of 2003, we do not currently face the same issues. In addition, our merchandise strategy is now focused on offering the most current trends, which allows us to generate a higher product margin while still providing significant value to our customers.

SELLING, MARKETING AND FULFILLMENT EXPENSES: Selling, marketing and fulfillment expenses increased by approximately 17.4% for the first nine months of 2004 compared to the first nine months of 2003. Selling, marketing and fulfillment expenses consist of the following:

	Nine Months Ended September 30, 2004	Nine Months Ended September 30, 2003	Percentage Difference increase (decrease)
Marketing	$ 1,389,000	$ 1,227,000	13.2%
Operating	3,891,000	3,451,000	12.7%
Technology	3,134,000	2,579,000	21.5%
E-Commerce	1,304,000	1,020,000	27.8%
	$ 9,718,000	$ 8,277,000	17.4%

As a percentage of net sales, our selling, marketing and fulfillment expenses decreased slightly to 33.2% for the nine months ended September 30, 2004 from 34.6% for the nine months ended September 30, 2003. The decrease in selling, marketing and fulfillment expenses as a percentage of net sales resulted from efficiencies in our marketing and operating expenses, both of which increased at a lower rate than our net sales.

Marketing expenses include expenses related to online and print advertising, direct mail campaigns as well as staff related costs. Marketing expenses increased in the first nine months of 2004 by approximately 13.2% compared to the first nine months of 2003. Marketing expenses increased by a lower percentage than revenue primarily because of the increases in average order size and in the percentage of total revenue generated from repeat customers. The average order size for the first nine months of 2004 was approximately $186, as compared to approximately $168 for the first nine months of 2003. Revenue from repeat customers represented 70% of total revenue for the nine months ended September 30, 2004, as compared to 68% for the nine months ended September 30, 2003. Customer acquisition costs remained relatively unchanged at $10.04 per customer for the nine months ended September 30, 2004, from $10.05 per customer for the nine months ended September 30, 2003. On average, the positive contribution to overhead that we generate from a customer's purchase exceeds our current customer acquisition costs by a significant margin. Accordingly, we believe that it may be prudent to continue to be more aggressive in acquiring customers (even though it may increase our customer acquisition costs for the remainder of 2004 and beyond) in order to acquire larger numbers of customers with profitable ordering patterns.

Operating expenses include all costs related to inventory management, fulfillment, customer service, and credit card processing. Operating expenses increased in the first nine months of 2004 by approximately 12.7% compared to the first nine months of

2003 as a result of variable costs associated with the increased sales volume (e.g., picking and packing orders, processing returns and credit card fees), as well as costs associated with our seasonal clearance store, which closed in March. Operating expenses increased by a lower percentage than revenue primarily as a result of economies of scale, as the fixed costs associated with our fulfillment operations are allocated over a larger revenue base. Our goal is to achieve greater economies of scale as our business grows, although there can be no assurance that we will be successful in doing so.

Technology expenses consist primarily of staff related costs, amortization of capitalized costs and Web Site hosting. For the nine months ended September 30, 2004 technology expenses increased by approximately 21.5% compared to the nine months ended September 30, 2003. This increase resulted from an increase in headcount and salary related expenses, an increase in web hosting expense, consulting expense and was offset by a decrease in depreciation expense.

E-Commerce expenses include expenses related to our photo studio, image processing, and Web Site design. For the nine months ended September 30, 2004, this amount increased by approximately 27.8% as compared to the nine months ended September 30, 2003, primarily due to an increase in salary related expenses as well as an increase in expenses associated with outside research tools. We believe that our increased investment in the e-commerce group played a key role in the growth of our business during the first nine months, and we intend to continue to invest in this area in the near future.

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 nine months ended September 30, 2004 increased by approximately 26.1% to $4,896,000 as compared to $3,883,000 for the nine months ended September 30, 2003. The increase in general and administrative expenses was the result of increased salary and benefit expenses, as well as approximately $325,000 of expenses (including $113,000 of non-cash charges resulting from a stock option grant) incurred in connection with the separation agreement with our former CEO, as well as an increase in public company expenses, and were partially offset by a decrease in professional and consulting fees. As a percentage of net sales, general and administrative expenses for the first nine months of 2004 and 2003 remained relatively unchanged at approximately 16%.

LOSS FROM OPERATIONS: Operating loss decreased by almost 35% in the first nine months of 2004 to $4,059,000 from $6,240,000 in the first nine months of 2003 as a result of the increase in gross margin and revenue.

INTEREST AND OTHER INCOME: Other income for the nine months ended September 30, 2004 increased to $815,000 from $28,000 for the nine months ended September 30, 2003. The increase resulted from $564,000 recognized to adjust a liability associated with warrants issued by us to their fair value as of June 17, 2004 (at which time the warrants were re-classified as equity as described in Note 3 to our financial statements), the $169,000 realized in connection with the judgment we received in the Breider Moore litigation and an increase in interest income earned on our cash balance.

INTEREST EXPENSE: Interest expense for the nine months ended September 30, 2004 totaled $554,000, and related primarily to fees paid in connection with the Loan Facility and interest expense on the Convertible Notes. For the nine months ended September 30, 2003, interest expense totaled $268,000, 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 SEPTEMBER 30, 2004 COMPARED TO THE THREE MONTHS ENDED SEPTEMBER 30, 2003

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

	2004		2003		
		As a % of Net Sales		As a % of Net Sales	

Net sales	$ 8,675	100.0%	$ 8,210	100.0%	$
Cost of sales	5,709	65.8%	6,462	78.7%	
Gross profit	2,966	34.2%	1,748	21.3%	
Selling, marketing and fulfillment expenses	3,059	35.2%	2,883	35.1%	
General and administrative expenses	1,743	20.1%	1,274	15.5%	
Total operating expenses	4,802	55.3%	4,157	50.6%	
Operating loss	(1,836)	(21.1)%	(2,409)	(29.3)%	
Interest (expense) and other income, net	(124)	(1.4)%	(108)	(1.3)%	
Net loss	(1,960)	(22.5)%	(2,517)	(30.6)%	

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BLUEFLY, INC.
SEPTEMBER 30, 2004

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

	2004	2003
Average Order Size (including shipping & handling)	$ 179.48	$ 161.87
Average Order Size Per New Customer (including shipping & handling)	$ 151.40	$ 144.69
Average Order Size Per Repeat Customer (including shipping & handling)	$ 194.31	$ 171.51
New Customers Added during the Period	25,792	29,522
Revenue from Repeat Customers as a % of total Revenue	71%	68
Customer Acquisition Costs	$ 8.41	$ 10.52

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 (which includes sales of product and shipping revenue) for the three months ended September 30, 2004 increased by approximately 1.8% to $13,819,000, from $13,574,000 for the three months ended September 30, 2003. For the three months ended September 30, 2004, we recorded a provision for returns and credit card chargebacks and other discounts of $5,144,000, or approximately 37.2% of gross sales. For the three months ended September 30, 2003, the provision for returns and credit card chargebacks and other discounts was $5,364,000, or approximately 39.5% of gross sales. The decrease in this provision as a percentage of gross sales resulted from a slight decrease in the return rate. While we continue to test smaller changes to our merchandise mix as well as improvements to our product descriptions and packaging in order to decrease return rates, there can be no assurance that return rates will continue to decline, and, they may, in fact, increase.

After the necessary provisions for returns, credit card chargebacks and adjustments for uncollected sales taxes, our net sales for the three months ended September 30, 2004 were $8,675,000. This represents an increase of approximately 6% compared to the three months ended September 30, 2003, in which net sales totaled $8,210,000. The growth in net sales resulted primarily from the decrease in return rate, as well as an increase in average order size (approximately 11% higher compared to the third quarter of 2003), partially offset by a decrease in the number of orders. For the three months ended September 30, 2004, revenue from shipping and handling (which is included in net sales) increased by 11% to $709,000 from $640,000 for the quarter ended September 30, 2003. Shipping and handling revenue increased at a slightly higher rate than revenue as a whole because we have not offered as many free shipping promotions in 2004, although this effect has been partially offset by an increase in average order size.

COST OF SALES: Cost of sales for the three months ended September 30, 2004 totaled $5,709,000, resulting in gross margin of approximately 34.2%. Cost of sales for the three months ended September 30, 2003 totaled $6,462,000, resulting in gross margin of 21.3%. Gross profit increased by more than 69%, to $2,966,000 for the three months ended September 30, 2004 compared to $1,748,000 for the three months ended September 30, 2003. The growth in gross margin is primarily the result of increased product margins. Our gross margins were lower in 2003 than they had been historically because we decided to turn more of our out-of-season merchandise, as well as inventory items that we were particularly deep in, into cash that could be used to purchase new inventory, rather than holding the inventory for the next season. Because we currently have significantly more cash than we

did during a large part of 2003, we do not currently face the same issues. In addition, our merchandise strategy is now focused on offering the most current trends, which allows us to generate a higher product margin while still providing significant value to our customers.

SELLING, MARKETING AND FULFILLMENT EXPENSES: Selling, marketing and fulfillment expenses increased by approximately 6.1% for the three months ended September 30, 2004 compared to the three months ended September 30, 2003. Selling, marketing and fulfillment expenses were comprised of the following:

	Three Months Ended September 30, 2004	Three Months Ended September 30, 2003	Percentage Diffe increase (decre
Marketing	$ 365,000	$ 451,000	
Operating	1,069,000	1,202,000	
Technology	1,114,000	817,000	
E-Commerce	511,000	413,000	
	$ 3,059,000	$ 2,883,000	

As a percentage of net sales, our selling, marketing and fulfillment expenses remained relatively unchanged at 35%.

Marketing expenses decreased because our total customer acquisition costs in the quarter were lower, due in part to the fact that we did not do a direct mail campaign in the third quarter of 2004 and did not generate as much revenue through our affiliate program, which requires us to pay a commission on each sale. As a result, the total number of customers acquired during the quarter decreased by approximately 14.5%, to 25,792 in the three months ended September 30, 2004 from 29,522 in the three months ended September 30, 2003, while customer acquisition costs decreased to $8.41 per customer for the three months ended September 30, 2004, from $10.52 per customer for the three months ended September 30, 2003. On average, the positive contribution to overhead that we generate from a customer's purchase exceeds our current customer acquisition costs by a significant margin. Accordingly, we believe that it may be prudent to be more aggressive in acquiring customers (even though it may increase our customer acquisition costs during the remainder of 2004 and beyond) in order to acquire larger numbers of customers with profitable ordering patterns.

Operating expenses decreased for the three months ended September 30, 2004 by approximately 11% compared to the three months ended September 30, 2003. This decrease was primarily the result of certain contractual pricing rebates we received from our third party fulfillment center. Our goal is to achieve greater economies of scale as our business grows, although there can be no assurance that we will be successful in doing so.

For the three months ended September 30, 2004, technology expenses increased by approximately 36% compared to the three months ended September 30, 2003. This increase resulted from an increase in headcount and salary related expense, depreciation expense, consulting expenses and an increase in web hosting expense.

For the three months ended September 30, 2004, e-commerce expenses increased by approximately 24% as compared to the three months ended September 30, 2003, primarily due to an increase in salary related expenses as well as an increase in expenses associated with outside research tools.

GENERAL AND ADMINISTRATIVE EXPENSES: General and administrative expenses for the three months ended September 30, 2004 increased by approximately 37% to $1,743,000 as compared to $1,274,000 for the three months ended September 30, 2003. The increase in general and administrative expenses was primarily the result of approximately $325,000 of expenses (including $113,000 of non-cash charges resulting from a stock option grant) incurred in connection with the separation agreement with our former CEO. As a percentage of net sales, general and administrative expenses for the three months ended September 30, 2004 increased to approximately 20% from 15.5% for the three months ended September 30, 2003.

LOSS FROM OPERATIONS: Operating loss decreased by almost 24% for the three months ended September 30, 2004 to $1,836,000 from $2,409,000 for the three months ended September 30, 2003, primarily as a result of the increase in gross margin and revenue.

INTEREST AND OTHER INCOME: Other income for the three months ended September 30, 2004 increased to $30,000 from $6,000 for the three months ended September 30, 2003. The increase resulted from an increase in interest income earned on our cash balance.

INTEREST EXPENSE: Interest expense for the three months ended September 30, 2004 totaled $154,000, and related primarily to fees paid in connection with the Loan Facility and interest expense on the Convertible Notes. For the three months ended September 30, 2003, interest expense totaled $114,000, 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.

LIQUIDITY AND CAPITAL RESOURCES

General

At September 30, 2004, we had approximately $7.4 million of liquid assets, entirely in the form of cash and cash equivalents, and working capital of approximately $7.6 million (both amounts exclude the $1.25 million of restricted cash). In addition, as of September 30, 2004, we had approximately $2.5 million of borrowings committed under the Loan Facility, leaving approximately $1.0 million of availability.

We fund our operations through cash on hand, operating cash flow, as well as the proceeds of any equity or debt financing. Operating cash flow is affected by gross revenue and product margin levels, as well as return rates, 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 $7.0 million of tangible net worth, $6.0 million of working capital and cash balances of at least $750,000 (exclusive of the $1.25 million cash collateral pledged to Rosenthal to secure our obligations under the Loan Facility). 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.

We believe that our current funds, together with working capital, will be sufficient to enable us to meet our planned expenditures through at least December 31, 2004. We may seek additional equity or debt financing to maximize the growth of our business or if anticipated operating results are not achieved. If such financings are not available on terms acceptable to us, and/or we do not achieve our operating plan, future operations will need to be modified, scaled back or discontinued.

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 April 2004 to: (i) extend the term until March 30, 2005; (ii) substitute $1.25 million of cash collateral pledged by the Company for the $2.0 million standby letter of credit previously provided by Soros as collateral security for the Company's obligations under the Loan Facility; (iii) decrease the maximum amount available under the Loan Facility from $4.5 million to $4.0 million; (iv) increase the tangible net worth requirement to $7.0 million; (v) increase the working capital requirement to $6.0 million; and (vi) increase the minimum cash balance that the Company is required to maintain to $750,000 (exclusive of the $1.25 million in cash collateral). Because we removed the requirement that Soros provide a standby letter of credit to secure the Loan Facility, we are no longer subject to an agreement with Soros that previously required us to issue additional warrants to Soros with an exercise price equal to 75% of market price in the event that Rosenthal were to draw on Soros' letter of credit.

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%. We pay an annual facility fee equal to 1.5% of the portion of the Loan Facility that

is provided on the basis of our inventory level. This formula currently results in an annual facility fee of $33,750. 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 (including the $1.25 million of cash collateral, which has been placed in a segregated, restricted account) upon an event of default and certain of our cash accounts in the event that the total amount of funded debt loaned to us under the Loan Facility exceeds 90% of the maximum amount available under the Loan Facility for more than 10 days.

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.

Commitments and Long Term Obligations

As of September 30, 2004, we had the following commitments and long term obligations:

	2004	2005	2006	2007	2008	Thereafte
Marketing and Advertising	$ 49,000	185,000	--	--	--	-
Operating Leases	$ 115,000	462,000	469,000	481,000	442,000	476,00
Capital Leases	$ 81,000	151,000	54,000	27,000	--	-
Employment Contracts	$ 507,000	1,066,000	730,000	99,000	--	-
Notes payable to shareholders	$ 182,000	4,000,000	--	--	--	-
Grand total	$ 934,000	5,864,000	1,253,000	607,000	442,000	476,00

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 our business. 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.

RECENT ACCOUNTING PRONOUNCEMENTS

In March, 2004, the Emerging Issues Task Force issued EITF 03-6, "Participating Securities and the Two-Class Method under FASB Statement No. 128". This statement provides additional guidance on the calculation and disclosure requirements for earnings per share. The FASB concluded in EITF 03-6 that companies with multiple classes of common stock or participating securities, as defined by SFAS No. 128, calculate and disclose earnings per share based on the two-class method. The adoption of this statement does not have an impact to the Company's financial statement presentation as the Company is currently in a loss position.

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.

ITEM 4. CONTROLS AND DISCLOSURES.

As of the end of the period covered by this Form 10-Q, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer along with our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)). Based upon that evaluation, our Chief Executive Officer along with our Chief Financial Officer concluded that our disclosure controls and procedures are effective in timely alerting them to material information relating to us (including our consolidated subsidiaries) required to be included in our periodic SEC filings. There have been no changes in our internal control over financial reporting that occurred during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially

affect, our internal control over financial reporting.

SPECIAL NOTE REGARDING FORWARD LOOKING STATEMENTS

This report may include statements that constitute "forward-looking" statements, usually containing the words "believe", "project", "expect", or similar expressions. These statements are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements inherently involve risks and uncertainties that could cause actual results to differ materially from the forward-looking statements. The risks and uncertainties are detailed from time to time in reports filed by us with the Securities and Exchange Commission, including Forms 8-A, 8-K, 10-Q, and 10-K. These risks and uncertainties include, but are not limited to, the following: our history of losses and anticipated future losses; need for additional capital and potential inability to raise such capital; the risk of default by us under the Rosenthal financing agreement and the consequences that might arise from us having granted a lien on substantially all of our assets under that agreement; potential dilution arising from future equity financings, including potential dilution as a result of the anti-dilution provisions contained in our Preferred Stock and Convertible Notes; risks associated with Soros owning a majority of our stock; the potential failure to forecast revenues and/or to make adjustments to our operating plans necessary as a result of any failure to forecast accurately; unexpected changes in fashion trends; cyclical variations in the apparel and e-commerce markets; risks of litigation for sale of unauthentic or damaged goods and litigation risks related to sales in foreign countries; the dependence on third parties and certain relationships for certain services, including our dependence on U.P.S. (and the risks of a mail slowdown due to terrorist activity) and our dependence on our third-party web hosting and fulfillment centers; online commerce security risks; risks related to brand owners' efforts to limit our ability to purchase products indirectly; management of potential growth; the competitive nature of our business and the potential for competitors with greater resources to enter the business; the availability of merchandise; the need to further establish brand name recognition; risks associated with our ability to handle increased traffic and/or continued improvements to its Web site; rising return rates; dependence upon executive personnel; the successful hiring and retaining of new personnel; risks associated with expanding our operations; risks associated with potential infringement of other's intellectual property; the potential inability to protect our intellectual property; government regulation and legal uncertainties; uncertainties relating to the imposition of sales tax on Internet sales; and risks associated with the agreements with Soros with respect to a change of control and the liquidation preference of the Preferred Stock owned by Soros.

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 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

On July 29, 2004, we held our annual meeting of stockholders. At the meeting, our stockholders voted for six directors, electing E. Kenneth Seiff, Melissa Payner-Gregor, Josephine Esquivel, Alan Kane, Martin Miller and Robert Stevens as members of our board of directors. In addition, our stockholders voted in favor of proposals to (i) approve amendments to our 1997 Stock Option Plan, and (ii) approve the conversion provisions of our Convertible Notes. The results of the voting were as follows:

PROPOSAL	VOTES FOR	VOTES WITHHELD
Election of E. Kenneth Seiff	63,220,080	877,855
Election of Melissa Payner-Gregor	63,224,102	873,833
Election of Josephine Esquivel	63,876,970	220,965
Election of Alan Kane	63,877,270	220,665
Election of Martin Miller	63,871,078	226,857
Election of Robert Stevens	63,224,322	873,613

	VOTES FOR	VOTES AGAINST	ABSTENTIONS AND BROKER NON-VOTES
Approval of Amendments to the 1997 Stock Option Plan	59,112,785	318,799	4,666,351
Approval of Conversion Provisions of the Convertible Notes	58,485,179	945,018	4,667,738

In addition to the directors elected at the meeting, Neal Moszkowski and David Wassong have been elected to the Board of Directors as the designees of the Series A Preferred Stock and the Series B Preferred Stock, respectively.

ITEM 6. EXHIBITS

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

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

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BLUEFLY, INC.
SEPTEMBER 30, 2004

SIGNATURES

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

BLUEFLY, INC.

By: /s/ Melissa Payner-Gregor

Melissa Payner-Gregor
Chief Executive Officer

By: /s/ Patrick C. Barry

Patrick C. Barry
Chief Financial Officer

November 10, 2004

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