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

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended August 31, 2011

OR

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

For the transition period from to

Commission File Number: 0-18926

JOE S JEANS INC.

(Exact name of registrant as specified in its charter)

Delaware	**11-2928178**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
2340 South Eastern Avenue, Commerce, California	**90040**
(Address of principal executive offices)	(Zip Code)

(323) 837-3700

(Registrant s telephone number, including area code)

NO CHANGE

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or such shorter period that the registrant was required to submit and post such files). x Yes o No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer o	Accelerated filer x
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company x

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

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

Table of Contents

JOE S JEANS INC.

QUARTERLY REPORT ON FORM 10-Q

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

Table of Contents

PART I FINANCIAL INFORMATION

Item 1. **Financial Statements.**

JOE S JEANS INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except per share data)

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

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

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

Table of Contents

JOE S JEANS INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share data)

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

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

Table of Contents

JOE S JEANS INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

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

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

Table of Contents

JOE S JEANS INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

(in thousands)

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

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

Table of Contents

JOE S JEANS INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - BASIS OF PRESENTATION

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

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

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

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

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

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

Table of Contents

NOTE 2 ADOPTION OF ACCOUNTING PRINCIPLES

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

NOTE 3 ACCOUNTS RECEIVABLE, INVENTORY ADVANCES AND DUE TO FACTOR

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

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

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

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

CIT Commercial Services

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

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

Table of Contents

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

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

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

NOTE 4 INVENTORIES

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

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

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

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

Table of Contents

NOTE 5 PROPERTY AND EQUIPMENT

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

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

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

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

NOTE 6 RELATED PARTY TRANSACTIONS

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

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

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

Joe Dahan

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

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

Table of Contents

Albert Dahan

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

Effective as of June 1, 2009, we entered into a license agreement for the license of the children s product line with Kids Jeans LLC, or Kids LLC, an entity in which Mr. Albert Dahan holds an interest and has voting control. Under the terms of the license, Kids LLC had an exclusive right to produce, distribute and sell children s products bearing the Joe s® brand on a worldwide basis, subject to certain limitations on the channels of distribution. In exchange for the license, Kids LLC paid us a royalty payment of 20 percent on the first $5,000,000 in net sales, or $1,000,0000. In April 2011, we terminated the license agreement and in June 2011, we entered into a settlement agreement with Kids LLC. Pursuant to the terms of the settlement agreement, Kids LLC agreed to pay to us approximately $450,000 in exchange for Kids LLC s right to continue to sell children s apparel products until September 30, 2011 or December 31, 2011, depending on the product to be sold and customer to whom it will be sold. In exchange, the parties entered into mutual releases with respect to all claims related to the subject matter.

NOTE 7 EARNINGS PER SHARE

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

Three months ended

During the six months ended June 30, 2006, we received revenue of $9,315 in connection with structuring investments and revenue of $13,299 from providing asset-based management services on behalf of the CPA® REITs, exclusive of that portion of such revenue being

satisfied by the CPA® REITs through the issuance of their restricted common stock rather than paying cash. In January 2006, we received $15,474 from the annual installment of deferred acquisition revenue, including interest. The installments are subject to certain subordination provisions. CPA®:16-Global has not yet met the subordination provisions and management currently anticipates that no deferred amounts will be recognized by us and payable by CPA®:16-Global before the first half of 2007.

Our real estate operations provided cash flows (contractual lease revenues, net of property-level debt service) of approximately $24,545. Annual cash flow from operations is currently projected to fund distributions to shareholders; however, operating cash flow fluctuates on a

quarterly basis due to factors that include the timing of the receipt of transaction-related revenue, the timing of certain compensation costs that are paid and receipt of the annual installment of deferred acquisition revenue and interest thereon in the first quarter.

INVESTING ACTIVITIES Our investing activities are generally comprised of real estate transactions (purchases and sales) and capitalized property related costs. During the six months ended June 30, 2006 we received $22,471 in proceeds from the sale of properties and investments of which $9,163 was placed in an escrow account for a potential future investment. We made capital improvements totaling $3,874 to existing properties and also paid our annual installment of deferred acquisition revenue of $524 to our former management company relating

to 1998 and 1999 property acquisitions. The remaining obligation as of June 30, 2006 is $661. We currently anticipate using cash from operations to fund the remaining obligation.

During the six months ended June 30, 2006, we provided our affiliate, CPA®:15, with $84,000 to fund the early repayment of a mortgage obligation. This loan was used to facilitate the completion of the sale of one of its properties and was repaid the next business day.

During the six months ended June 30, 2006, we received distributions of $3,255 from the CPA® REITs, with $1,646 included in cash flows from investing activities, representing an amount in excess of the income recognized on the CPA® REIT investments for financial reporting purposes.

FINANCING ACTIVITIES

During the six months ended

June 30, 2006, we paid distributions to shareholders of $34,356. In addition to paying distributions, our financing activities included making scheduled mortgage principal payments of $5,705 and paying down the outstanding balance on our credit facility by $13,000. Gross borrowings under the credit facility were $25,000, which were used for several purposes in the normal course of business, and repayments were $38,000. In addition, we obtained $30,000 from the refinancing of an investment leased to CheckFree Holdings that we now consolidate in accordance with EITF 04-05. Also during the six months ended June 30, 2006, we received $4,031 from the release of escrow funds that we deposited during 2005 in connection with obtaining mortgage financing on several investments and

raised $3,652 from the issuance of shares primarily through our Distribution Reinvestment and Share Purchase Plan.

In the case of limited recourse mortgage financing that does not fully amortize over its term or is currently due, we are responsible for the balloon payment only to the extent of our interest in the encumbered property because the holder generally has recourse only to the collateral. When balloon payments come due, we may seek to refinance the loans, restructure the debt with the existing lenders or evaluate our ability to satisfy the obligation from our existing resources including our revolving line of credit. To the extent the remaining initial lease term on any property remains in place for a number of years beyond the balloon payment date, we believe that the ability to refinance

balloon payment obligations is enhanced. We also evaluate our outstanding loans for opportunities to refinance debt at lower interest rates that may occur as a result of decreasing interest rates or improvements in the credit rating of tenants. We believe we have sufficient resources to pay off the loans if they are not refinanced.

27

W. P. CAREY & CO. LLC
ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)
(Amounts in thousands, except share amounts)

Cash Resources

As of June 30, 2006, we had $15,593 in cash and cash equivalents, which can be used for working capital needs and other commitments and may be used for future investments, including financing the purchase of certain properties from CPA®:12. We also have a credit facility with unused capacity of up to $173,000 available as of June 30, 2006, which is also available to meet working capital needs and other commitments. In addition, debt may be incurred on unleveraged properties with a carrying value of $225,382 as of June 30, 2006, subject to meeting certain financial ratios on our credit facility, and any proceeds may be used to finance future investments. We continue to evaluate fixed-rate financing options, such as obtaining limited recourse financing on our unleveraged properties. Any financing obtained may be used for working capital objectives and may be used to pay down existing debt balances. In addition, during July 2006, we received approximately $1,600 from CPA®:14 as part of a special cash distribution of $.45 per share to CPA®:14 shareholders in connection with the gain on sale of certain properties.

The credit facility has financial covenants requiring us, among other things, to maintain a minimum equity value and to meet or exceed certain operating and coverage ratios. We are in compliance with these covenants as of June 30, 2006. Advances are prepayable at any time. Amounts drawn on the credit facility, which expires in May 2007, bear interest at a rate of either (i) the one, two, three or six-month LIBOR, plus a spread which ranges from 0.6% to 1.45% depending on leverage or corporate credit rating or (ii) the greater of the bank s Prime Rate and the Federal Funds Effective Rate, plus .50%, plus a spread of up to .125% depending on our leverage ratio. We can renew the credit facility for an additional one year period.

	June 30, 2006		**December 31, 2005**	
	Maximum Available	**Outstanding Balance**	**Maximum Available**	**Outstanding Balance**
Credit Facility	$175,000	$2,000	$225,000	$15,000

Cash Requirements

During the next twelve months, cash requirements will include paying distributions to shareholders, scheduled mortgage principal payments (our next balloon payment is not due until August 2007), making distributions to minority partners as well as other normal recurring operating expenses. We may also seek to use our cash to invest in new properties, to repurchase shares under our share repurchase program and maintain cash balances sufficient to meet working capital needs. We may issue additional shares in connection with investments in real estate when it is consistent with the objectives of the seller.

We have budgeted capital expenditures of up to approximately $3,565 at various properties during the next twelve months. The capital expenditures will primarily be for tenant and property improvements in order to enhance a property s cash flow or marketability for re-leasing or sale.

We expect to meet our capital requirements to fund future investments, any capital expenditures on existing properties and scheduled debt maturities on limited recourse mortgages through use of our cash reserves or unused amounts on our credit facility.

Expected Impact of Proposed Merger

In connection with the proposed merger, if approved, we expect to receive approximately $48,845 in disposition and termination fees from CPA®:12 as well as $7,719 as part of a special cash distribution of $3.00 per share to CPA®:12 shareholders, however there can be no assurances that the merger will be completed. These funds will be used, along with our credit facility and existing cash resources, to finance the purchase of certain properties or interests in properties from CPA®:12 for approximately $120,500 in cash and the assumption of debt of approximately $78,700. We may also use our credit facility to loan up to $50,000 to CPA®:14 in connection with their merger with CPA®:12. Disposition fees approximating $5,970 to be received from CPA®:12 related to properties we acquire from CPA®:12 will not be recognized as income but will reduce the cost of the properties we acquire.

We currently estimate that the properties to be acquired from CPA®:12 will generate annual lease revenue and cash flow, inclusive of minority interest, of approximately $17,030 and $13,310, respectively, and annual equity income of approximately $1,870. This additional cash flow will be partially offset by lower annual asset management revenue approximating $1,990 and interest expense incurred related to any borrowing under our credit facility to finance this transaction.

W. P. CAREY & CO. LLC
ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)
(Amounts in thousands, except share amounts)

Summary of Financing

The table below summarizes our mortgage notes payable and unsecured line of credit as of June 30, 2006 and 2005, respectively.

	June 30,	
	2006	**2005**
Balance:		
Fixed rate	$ 202,488	$ 127,941
Variable rate	53,424	123,933
Total	$ 255,912	$ 251,874
Percent of total debt:		
Fixed rate	79%	51%
Variable rate	21%	49%
Total	100%	100%
Weighted average interest rate at end of period:		
Fixed rate	6.54%	7.44%
Variable rate	4.90%	5.69%

Aggregate Contractual Agreements

The table below summarizes our contractual obligations as of June 30, 2006 and the effect that such obligations are expected to have on our liquidity and cash flow in future periods.

	Total	**Less than 1 year**	**1-3 years**	**3-5 years**	**More than 5 years**
Mortgage notes payable Principal	$ 253,897	$ 11,624	$ 58,204	$ 47,543	$ 136,526
Mortgage notes payable Interest (1)	83,723	15,682	26,396	17,512	24,133
Credit facility Principal	2,000	2,000			
Credit facility Interest (1)	151	151			
Deferred acquisition compensation due to affiliates Principal	661	524	137		
Deferred acquisition compensation due to affiliates Interest	38	32	6		
Operating leases (2)	28,566	1,820	5,724	5,572	15,450
	$ 369,036	$ 31,833	$ 90,467	$ 70,627	$ 176,109

(1) Interest on variable rate debt obligations

was calculated using the variable interest rate as of June 30, 2006.

(2) Operating lease obligations consist primarily of the total minimum rents payable on the lease for our principal offices. We are reimbursed by affiliates for their share of the minimum rents under an office cost-sharing agreement. Such amounts are allocated among the entities, based on gross revenues and are adjusted quarterly.

Amounts related to our foreign operations are based on the exchange rate of the Euro as of June 30, 2006.

We have employment contracts with several senior executives. These contracts provide for severance payments in the event of termination under certain conditions including change in control.

As of June 30, 2006, we have no material capital lease obligations for which we are the lessee, either individually or in the aggregate.

Table of Contents

W. P. CAREY & CO. LLC

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

(in thousands except share and per share amounts)

Market risk is the exposure to loss resulting from changes in interest, foreign currency exchange rates and equity prices. In pursuing our business plan, the primary risks to which we are exposed are interest rate risk and foreign currency exchange risk.

Interest Rate Risk

The value of our real estate is subject to fluctuations based on changes in interest rates, local and regional economic conditions and changes in the creditworthiness of lessees, all which may affect our ability to refinance property-level mortgage debt when balloon payments are scheduled.

At June 30, 2006, $202,474 of our long-term debt bears interest at fixed rates, and therefore the fair value of these instruments is affected by changes in the market interest rates. The following table presents principal cash flows based upon expected maturity dates and scheduled amortization payments of our debt obligations and the related weighted-average interest rates by expected maturity dates for our fixed rate debt. Annual interest rates on fixed rate debt as of June 30, 2006 ranged from 4.87% to 10.125%. The annual interest rates on our variable rate debt as of June 30, 2006 ranged from 3.86% to 8.25%.

Advances from the line of credit bear interest at an annual rate of either (i) the one, two, three or six-month LIBOR, plus a spread which ranges from 0.6% to 1.45% depending on leverage or corporate credit rating or (ii) the greater of the bank s Prime Rate and the Federal Funds Effective Rate, plus .50%, plus a spread of up to .125% depending on our leverage.

	2006	2007	2008	2009	2010	Thereafter	Total	Fair value
Fixed rate debt	$4,325	$24,682	$9,737	$36,936	$13,984	$112,810	$202,474	$200,911
Weighted average interest rate	7.26%	7.80%	7.34%	7.31%	7.59%	4.75%		
Variable rate debt	$1,361	$ 4,816	$8,108	$ 3,291	$ 3,384	$ 32,463	$ 53,423	$ 53,423

Annual interest expense would increase or decrease on variable rate debt by approximately $534 for each 1% increase or decrease in interest rates. A change in interest rates of 1% would increase or decrease the fair value of our fixed rate debt at June 30, 2006 by approximately $3,911.

Foreign Currency Exchange Rate Risk

We have foreign operations in France and as such are subject to risk from the effects of exchange rate movements of the Euro, which may affect future costs and cash flows. We are a net receiver of the Euro (we receive more cash than we pay out) and therefore our foreign operations benefit from a weaker U.S. dollar and are adversely affected by a stronger U.S. dollar relative to the Euro. For the three months ended June 30, 2006 and 2005, we recognized a gain of $17 and a loss of $25, respectively, and for the six months ended June 30, 2006 and 2005, we recognized a gain of $102 and a loss of $11, respectively, in foreign currency transaction gains in connection with the transfer of cash from foreign operating subsidiaries to the parent company. The cash received was subsequently converted into dollars. In addition, for the three months ended June 30, 2006 and 2005, we recognized net unrealized foreign currency gains of $400 and losses of $456, respectively. The cumulative foreign currency translation adjustment reflects a loss of $560 as of June 30, 2006. To date, we have not entered into any foreign currency forward exchange contracts or other derivative financial instruments to hedge the effects of adverse fluctuations in foreign currency exchange rates.

Table of Contents

W. P. CAREY & CO. LLC

ITEM 4. CONTROLS AND PROCEDURES

(A) Disclosure Controls and Procedures

Our disclosure controls and procedures include our controls and other procedures designed to provide reasonable assurance that information required to be disclosed in this and other reports filed under the Securities Exchange Act of 1934, as amended (the Exchange Act) is accumulated and communicated to our management, including our chief executive officer and acting chief financial officer, to allow timely decisions regarding required disclosure and to ensure that such information is recorded, processed, summarized and reported, within the required time periods specified in the SEC s rules and forms. It should be noted that no system of controls can provide complete assurance of achieving a company s objectives, and that future events may impact the effectiveness of a system of controls.

Our chief executive officer and acting chief financial officer have conducted a review of our disclosure controls and procedures as of June 30, 2006. Based upon this review, our chief executive officer and acting chief financial officer have concluded that our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act) were effective as of June 30, 2006 at a reasonable level of assurance and procedures to ensure that the information required to be disclosed in the reports we file under the Exchange Act is recorded, processed, summarized and reported within the required time periods specified in the SEC s rules and forms.

(B) Changes in Internal Control Over Financial Reporting

There have been no changes in our internal control over financial reporting during our most recently completed fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

W. P. CAREY & CO. LLC
PART II
(Amounts in thousands, except share amounts)

ITEM 1. LEGAL PROCEEDINGS

Refer to Note 8, Commitments and Contingencies, of the consolidated financial statements for information regarding legal proceedings.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Issuer Purchases of Equity Securities There were no issuer purchases of equity securities during the three months ended June 30, 2006. In December 2005, our board of directors approved a share repurchase program that gives us authorization to repurchase up to $20,000 of our common stock in the open market beginning December 16, 2005 and over the next 12 months as conditions warrant. As of June 30, 2006, the maximum approximate dollar value of shares that may yet be purchased under the plan approximated $17,316.

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

The annual shareholders meeting was held on June 7, 2006, at which time a vote was taken to elect our directors through the solicitation of proxies. The shareholders elected the following directors for the ensuing year:

Name of Director	Total Shares Voting	Shares Voting For	Shares Withheld
Francis J. Carey	30,802,067	30,510,520	291,547
Wm. Polk Carey	30,802,067	30,559,256	242,811
Nathaniel S. Coolidge	30,802,067	29,067,263	1,734,804
Gordon F. DuGan	30,802,067	30,576,507	225,560
Eberhard Faber IV	30,802,067	29,117,296	1,684,771
Lawrence R. Klein	30,802,067	30,549,785	252,282
Charles E. Parente	30,802,067	30,541,472	260,595
George E. Stoddard	30,802,067	30,072,064	730,003
C. C. Townsend, Jr.	30,802,067	29,525,519	1,276,548
Karsten von Köller	30,802,067	30,613,484	188,583
Reginald H. Winssinger	30,802,067	30,616,098	185,969

The shareholders elected to amend and restate our Amended and Restated Limited Liability Company Agreement to conform the provision regarding sales of assets to a corresponding provision of the Delaware General Corporate Law:

Shares Voting For	20,549,157
Shares Voting Against	130,496
Shares Abstaining	412,229
Non-votes	9,710,185

ITEM 6. EXHIBITS

10.1 Agreement for Sale and Purchase, dated June 29, 2006, by and among Corporate Property Associates 12 Incorporated, the entities listed on schedule 1 named therein, Carey Asset Management Corp. and W. P. Carey & Co. LLC (Incorporated by reference to Form 8-K, dated July 6, 2006).

10.2 W. P. Carey & Co. LLC Amended and Restated Limited Liability Company Agreement.

31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32 Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Table of Contents

W. P. CAREY & CO. LLC

SIGNATURES

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

W.P. CAREY & CO. LLC

8/9/2006 Date	By: /s/ Mark J. DeCesaris Mark J. DeCesaris Managing Director and acting Chief Financial Officer (acting Principal Financial Officer)
8/9/2006 Date	By: /s/ Claude Fernandez Claude Fernandez Managing Director and Chief Accounting Officer (Principal Accounting Officer)

33