TARRANT APPAREL GROUP
Form 10-K/A
January 14, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K/A

Amendment No. 2

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2006

or

[_] 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: 0-26006

TARRANT APPAREL GROUP

(Exact name of registrant as specified in its charter)

California	**95-4181026**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

3151 East Washington Boulevard
Los Angeles, California 90023
(Address of principal executive offices) (Zip code)

Registrant's telephone number, including area code: (323) 780-8250

Securities registered pursuant to Section 12(b) of the Act:

TITLE OF EACH CLASS	NAME OF EACH EXCHANGE ON WHICH REGISTERED
Common Stock	Nasdaq Global Market

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes [_] No [X]

Indicate by check mark if the registration is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes [_] No [X]

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. Yes [X] No [_]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. Large accelerated filer [_] Accelerated filer [_] Non-accelerated filer [X]

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

The aggregate market value of the Common Stock held by non-affiliates of the Registrant is approximately $34,264,994 based upon the closing price of the Common Stock on June 30, 2006.

Number of shares of Common Stock of the Registrant outstanding as of March 23, 2007: 30,543,763.

DOCUMENTS INCORPORATED BY REFERENCE

None.

EXPLANATORY NOTE

We are filing this Amendment No. 2 to Annual Report on Form 10-K/A for the year ended December 31, 2006 (the "Amendment"), to amend our Annual Report on Form 10-K for the year ended December 31, 2006, which was originally filed with the Securities and Exchange Commission (the "SEC") on March 27, 2007, and amended by Amendment No. 1 to Annual Report on Form 10-K/A filed with the SEC on April 30, 2007 (as amended, the "Original Annual Report"). The Company is filing this Amendment in response to comments received from the SEC. The following Items amend the Original Annual Report, as permitted by the rules and regulations of the SEC.

Except as described above, no other changes have been made to the Original Annual Report. This Amendment continues to speak as of the date of the Original Annual Report, and we have not updated the disclosures contained therein to reflect any events which occurred at a date subsequent to the filing of the Original Annual Report. Accordingly, this Amendment should be read in conjunction with the Original Annual Report.

As a result of these amendments, we are also filing as exhibits to this Amendment the certifications pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. Because no financial statements are contained within this Amendment, we are not including certifications pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

PART II

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis should be read together with the Consolidated Financial Statements of Tarrant Apparel Group and the "Notes to Consolidated Financial Statements" included elsewhere in this Form 10-K. This discussion summarizes the significant factors affecting the consolidated operating results, financial condition and liquidity and cash flows of Tarrant Apparel Group for the fiscal years ended December 31, 2004, 2005 and 2006. Except for historical information, the matters discussed in this Management's Discussion and Analysis of Financial Condition and Results of Operations are forward looking statements that involve risks and uncertainties and are based upon judgments concerning various factors that are beyond our control. See "Cautionary Statement Regarding Forward-Looking Statements" and "Item 1A. Risk Factors."

Overview

Tarrant Apparel Group is a design and sourcing company for private label and private brand casual apparel serving mass merchandisers, department stores, branded wholesalers and specialty chains located primarily in the United States. Our private brands include American Rag Cie and Alain Weiz.

We generate revenues from the sale of apparel merchandise to our customers that we have manufactured by third party contract manufacturers located outside of the United States. Revenues and net income (loss) for the years ended December 31, 2004, 2005 and 2006 were as follows (dollars in thousands):

REVENUES AND NET INCOME (LOSS):	2004	2005	2006
Net sales	$ 155,453	$ 214,648	$ 232,402
Net income (loss)	$ (104,677)	$ 993	$ (22,221)

Cash flows for the years ended December 31, 2004, 2005 and 2006 were as follows (dollars in thousands):

CASH FLOWS:	2004	2005	2006
Net cash provided by (used in) operating activities	$ 12,168	$ (12,900)	$ 15,047
Net cash provided by (used in) investing activities	$ 1,250	$ 3,555	$ (5,071)
Net cash provided by (used in) financing activities	$ (15,552)	$ 9,772	$ (10,713)

Significant Developments in 2006

The Buffalo Group

On December 6, 2006, we entered into a definitive stock and asset purchase agreement (the “Purchase Agreement”) to acquire certain assets and entities comprising The Buffalo Group. The Buffalo Group designs, imports and sells contemporary branded apparel and accessories, primarily in Canada and the United States.

Pursuant to the Purchase Agreement, we and our subsidiaries agreed to acquire (1) all the outstanding capital stock of four principal operating subsidiaries of The Buffalo Group — Buffalo Inc., 3163946 Canada Inc., 3681441 Canada Inc. and Buffalo Corporation, and (2) certain assets, consisting primarily of intellectual property rights and licenses, from The Buffalo Trust. The consideration for the stock and assets to be purchased by us under the Purchase Agreement will consist of:

- $40,000,000 in cash, subject to reduction prior to closing;
- $15,000,000 in promissory notes that are due and payable in five equal annual installments beginning on the second anniversary of the closing date;
- The issuance to the sellers of 13,000,000 exchangeable shares of our Canadian subsidiary, which shares will be exchangeable by the holders into shares of our common stock on a 1-to-1 basis;
- The issuance by us to a trustee of shares of our Series A Special Voting Preferred Stock that will entitle the sellers to direct the trustee to vote a number of shares equal to the number of exchangeable shares of our Canadian subsidiary that remain outstanding from time to time on all matters on which our shareholders are entitled to vote;
- Assumption of debt of the entities being acquired by us; and
- Earn-out payments of up to $12,000,000 in the aggregate over a four year period, contingent upon achievement by the acquired business of specified earnings targets in years 2007 through 2010.

In addition, we may be required to make a contingent cash payment following the fifth anniversary of the closing if the average price of our common stock does not equal or exceed $3.076 within any 10 trading days during the five year period following the closing of the purchase transaction.

At signing of the Purchase Agreement, we delivered $5,000,000 to the sellers as a deposit against the purchase price payable under the agreement. Upon closing, this deposit will be used to pay a portion of the consideration payment and will reduce the amount of cash delivered at closing. Under certain conditions specified under the agreement, if we or the Buffalo Group terminate the agreement prior to closing, the $5.0 million deposit may or may not be refundable to us.

Pursuant to the Purchase Agreement, at the closing we will enter into employment agreements with each of Gabriel Bitton, Gilbert Bitton, David Bitton, Charles Bitton and Michel Bitton pursuant to which they will serve as senior executives of the acquired business, and we have agreed to issue options to purchase an aggregate of 2,000,000 shares of our common stock to the Bittons. Gabriel Bitton will continue to serve as Chief Executive Officer of the acquired business following closing and will be appointed to our Board of Directors. A second nominee of the sellers reasonably acceptable to us will also be nominated to serve on our Board of Directors upon completion of the transaction.

The completion of the transaction is subject to the satisfaction of a number of conditions as set forth in the Purchase Agreement, including among others, the approval of the acquisition and related transactions by our shareholders, our obtaining the necessary financing to complete the acquisition, obtaining certain third party consents, and other customary closing conditions. Dates for closing the acquisition and for our shareholders' meeting to vote on the acquisition have not yet been determined. The Purchase Agreement may be terminated under certain conditions, including by mutual written consent of the parties, by either party in the event of a material breach by the other party, or by either party if the closing does not occur by April 30, 2007.

There are no material relationships between us and The Buffalo Group, other than in respect of the Purchase Agreement.

The Buffalo Group transaction is part of our strategy to grow and diversify our business. We believe its benefits to us will include:

- o Expanding our operations by adding additional proprietary brands and products to compete more effectively;
- o Expanding the scope, scale and strength of our operations by expanding its marketing, sales and distribution capabilities;
- o Enhancing our capabilities to compete in Canada, the United States and other markets; and utilize The Buffalo Group's existing sales and marketing infrastructure as a platform for expanding sales of our apparel products; and
- o Providing opportunities for us to penetrate new markets and expand our share in existing markets.

The Buffalo Group was started in 1985 as the distributor of Buffalo branded products in Canada. Initially, the Buffalo brand was a denim line, but it has been expanded over time. In 1993, The Buffalo Group widened its customer base by adding U.S. retailers. In 2000, The Buffalo Group started a private label business for retailers in Canada and the U.S. In 1996, Buffalo opened its first retail store in Canada. Currently it operates 45 retail stores in Canada. Over this time Buffalo has added additional brand names to its line. It has also developed a licensing program for the Buffalo brand for the sale of apparel-related products in Canada, and the sale of apparel products in foreign countries.

Private Label

Private label business has been our core competency for over twenty years, and involves a one to one relationship with a large, centrally controlled retailer with whom we can develop product lines that fit with the characteristics of their particular customer. Private label sales in 2006 were $181.2 million compared to $159.6 million in 2005.

Private Brands

We launched our private brands initiative in 2003, pursuant to which we acquire ownership of or license rights to a brand name and sell apparel products under this brand, generally to a single retail company within a geographic region. Private brands sales in 2006 were $51.2 million compared to $55.0 million in 2005. During 2006, we owned or licensed rights to the following private brands:

- o *American Rag CIE*: During the first quarter of 2005, we extended our agreement with Macy's Merchandising Group through 2014, pursuant to which we exclusively distribute our American Rag Cie brand through Macy's Merchandising Group's national Department Store organization of more than 600 stores. Net sales of American Rag Cie branded apparel totaled $34.4 million in 2006 compared to $21.8 million in 2005.
- o *Alain Weiz*: We have previously sold Alan Weiz apparel exclusively to Dillard's Department Stores. Net sales of Alain Weiz branded apparel totaled $5.5 million in 2006 compared to $5.3 million in 2005. From January 1, 2007, we may sell our licensed brand "Alain Weiz" to specialty stores and department stores.
- o *Souvenir by Cynthia Rowley*: In July 2006, we terminated our License Agreements and the parent guaranty with Cynthia Rowley. In consideration of termination of the License Agreements, $400,000 was paid to Cynthia Rowley in July 2006.

- *Gear 7*: During the fourth quarter of 2005, K-Mart discontinued sales of Gear 7 products, which resulted in a decline in sales for this brand in the fourth quarter of 2005. Net sales of Gear 7 branded apparel totaled $14.4 million in 2005. We did not have any sales of Gear 7 branded apparel in 2006.

- *Jessica Simpson* brands: The JS by Jessica Simpson brand was originally launched as a denim line with Charming Shoppes. Net sales of JS by Jessica Simpson and Princy by Jessica Simpson, which is the department store and better specialty store brand, totaled $8.9 million in 2006 compared to $12.6 million in 2005. In March 2006, we became involved in a dispute with the licensor of the Jessica Simpson brands over our continued rights to these brands, and we are presently in litigation with this licensor. Accordingly, we did not have any sales of Jessica Simpson branded apparel after the first quarter of 2006 and do not anticipate any sales unless and until we are able to successfully resolve our dispute and retain our rights to these brands.

- *House of Dereon by Tina Knowles:* We began shipping products for the House of Dereon by Tina Knowles brand in the fourth quarter of 2005, resulting in net sales of $309,000 in 2005. In March 2006, we terminated our license agreement for this brand, and sold our remaining inventory to the licensor or its designee. Prior to December 31, 2005, we had written off the capitalized balance of $1.2 million related to the agreement and recognized a corresponding loss in 2005. Net sales of House of Dereon by Tina Knowles branded apparel totaled $2.2 million in 2006 which included $1.5 million of sales of inventory to a designee of the licensor.

Notes Receivable – Related Party Reserve

In connection with the sale in 2004 of our assets and real property in Mexico, the purchasers of the Mexico assets issued us unsecured promissory notes of $3,910,000 that mature on November 30, 2007 and secured promissory notes of $40,204,000 that mature on December 31, 2014 and are payable in partial or total amounts anytime prior to the maturity of each note. The secured notes are secured by the real and personal property in Mexico that we sold to the purchasers. As of September 30, 2006, the outstanding balance of the notes and interest receivables were $41.1 million prior to the reserve. Historically, we have placed orders for purchases of fabric from the purchasers pursuant to the purchase commitment agreement we entered into at the time of the sale of the Mexico assets, and we have satisfied our payment obligations for the fabric by offsetting the amounts payable against the amounts due to us under the notes. However, during 2006, the purchasers ceased providing fabric and are not currently making payments under the notes. We further evaluated the recoverability of the notes receivable and recorded a loss on the notes receivable in the third quarter of 2006 in an amount equal to the outstanding balance less the value of the underlying assets securing the notes. The loss was estimated to be approximately $27.1 million, resulting in a net notes receivable balance at September 30, 2006 of approximately $14 million. We believe there was no significant change subsequently on the value of the underlying assets securing the notes; therefore, we did not have additional reserve in the fourth quarter of 2006. We will continue to pursue payment of all amounts under the notes receivable and believe the remaining $14 million balance at December 31, 2006 is realizable. The entire reserve was recorded in the Luxembourg geographic reporting segment.

Credit Facility Refinancing

In June 2006, we entered into a new $65 million credit facility with Guggenheim Corporate Funding, LLC (as agent for certain lenders) and expanded our existing facilities with GMAC Commercial Finance Credit, LLC and DBS Bank (Hong Kong) Limited. The credit facility with Guggenheim consists of an initial term loan of $25 million, of which $15.5 million was advanced at the initial closing. The initial term loan was or will be used to repay certain existing indebtedness and fund general operating and working capital needs. A second term loan of up to $40 million will be available to finance acquisitions acceptable to Guggenheim as agent. In addition, in June 2006, our credit facility with GMAC Commercial Finance Credit, LLC and other lenders was increased from $45 million to $55 million, and our credit facility with DBS Bank (Hong Kong) Limited was increased from $4.5 million to $25 million. These financings significantly expand our borrowing base, which provides us with enhanced financial flexibility.

Internal Revenue Service Audit

In January 2004, the Internal Revenue Service completed its examination of our Federal income tax returns for the years ended December 31, 1996 through 2001. The IRS has proposed adjustments to increase our income tax payable for the six years under examination. In addition, in July 2004, the IRS initiated an examination of our Federal income tax return for the year ended December 31, 2002. In March 2005, the IRS proposed an adjustment to our taxable income of approximately $9 million related to similar issues identified in their audit of the 1996 through 2001 federal income tax returns. The proposed adjustments to our 2002 federal income tax return would not result in additional tax due for that year due to the tax loss reported in the 2002 federal return. However, it could reduce the amount of net operating losses available to offset taxes due from the preceding tax years. This adjustment would also result in additional state taxes, penalties and interest. We believe that we have meritorious defenses to and intend to vigorously contest the proposed adjustments made to our federal income tax returns for the years ended 1996 through 2002. If the proposed adjustments are upheld through the administrative and legal process, they could have a material impact on our earnings and cash flow. We believe we have provided adequate reserves for any reasonably foreseeable outcome related to these matters on the consolidated balance sheets under the caption “Income Taxes”. The maximum amount of loss in excess of the amount accrued in the financial statements is $8.3 million. We do not believe that the adjustments, if any, arising from the IRS examination, will result in an additional income tax liability beyond what is recorded in the accompanying consolidated balance sheets.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities. We are required to make assumptions about matters, which are highly uncertain at the time of the estimate. Different estimates we could reasonably have used or changes in the estimates that are reasonably likely to occur could have a material effect on our financial condition or result of operations. Estimates and assumptions about future events and their effects cannot be determined with certainty. On an ongoing basis, we evaluate estimates, including those related to returns, discounts, bad debts, inventory, notes receivable – related parties reserve, intangible assets, income taxes, stock options valuation, contingencies and litigation. We base our estimates on historical experience and on various assumptions believed to be applicable and reasonable under the circumstances. These estimates may change as new events occur, as additional information is obtained and as our operating environment changes. In addition, management is periodically faced with uncertainties, the outcomes of which are not within its control and will not be known for prolonged period of time.

We believe our financial statements are fairly stated in accordance with accounting principles generally accepted in the United States of America and provide a meaningful presentation of our financial condition and results of operations.

We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements. For a further discussion on the application of these and other accounting policies, see Note 1 of the “Notes to Consolidated Financial Statements.”

Accounts Receivable — Allowance for Returns, Discounts and Bad Debts

We evaluate the collectibility of accounts receivable and chargebacks (disputes from the customer) based upon a combination of factors. In circumstances where we are aware of a specific customer’s inability to meet its financial obligations (such as in the case of bankruptcy filings or substantial downgrading of credit sources), a specific reserve for bad debts is taken against amounts due to reduce the net recognized receivable to the amount reasonably expected to be collected. For all other customers, we recognize reserves for bad debts and uncollectible chargebacks based on our historical collection experience. If collection experience deteriorates (for example, due to an unexpected material adverse change in a major customer’s ability to meet its financial obligations to us), the estimates of the recoverability of amounts due to us could be reduced by a material amount.

As of December 31, 2006, the balance in the allowance for returns, discounts and bad debts reserves was $2.1 million, compared to $3.0 million at December 31, 2005.

Inventory

Our inventories are valued at the lower of cost or market. Under certain market conditions, we use estimates and judgments regarding the valuation of inventory to properly value inventory. Inventory adjustments are made for the difference between the cost of the inventory and the estimated market value and charged to operations in the period in which the facts that give rise to the adjustments become known.

Valuation of Long-lived and Intangible Assets and Goodwill

We assess the impairment of identifiable intangibles, long-lived assets and goodwill whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors considered important that could trigger an impairment review include, but are not limited to, the following:

- o a significant underperformance relative to expected historical or projected future operating results;
- o a significant change in the manner of the use of the acquired asset or the strategy for the overall business; or
- o a significant negative industry or economic trend.

Effective January 1, 2002, we adopted Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets." According to this statement, goodwill and other intangible assets with indefinite lives are no longer subject to amortization, but rather an annual assessment of impairment applied on a fair-value-based test on an annual basis or more frequently if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount.

We utilized the discounted cash flow methodology to estimate fair value. At December 31, 2006, we have a goodwill balance of $8.6 million, and a net property and equipment balance of $1.4 million, as compared to a goodwill balance of $8.6 million and a net property and equipment balance of $1.7 million at December 31, 2005. During the years ended December 31, 2005 and 2006, we did not recognize any impairment related to goodwill and property and equipment.

We assess the carrying value of long-lived assets in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." In 2004, we evaluated the long-lived assets in Mexico for recoverability and concluded that the book value of the asset group was significantly higher than the expected future cash flows and that impairment had occurred. Accordingly, we recognized a non-cash impairment loss of approximately $78 million in the second quarter of 2004. The impairment charge was the difference between the carrying value and fair value of the impaired assets. Our determination of fair value was determined based on independent appraisals of the property and equipment obtained in June 2004.

Foreign Currency Translation

Assets and liabilities of our Mexico and Hong Kong subsidiaries are translated at the rate of exchange in effect on the balance sheet date; income and expenses are translated at the average rates of exchange prevailing during the respective periods. The functional currency in which we transact business in Hong Kong is the Hong Kong dollar and in Mexico is the peso. At December 31, 2006, we had one open foreign exchange forward contract with a maturity of less than one year. Hedge ineffectiveness resulted in a loss totaling $196,000 during the year.

Transaction gains or losses, other than inter-company debt deemed to be of a long-term nature, are included in net income (loss) in the period in which they occur.

Revenue Recognition

Revenue is recognized at the point of shipment for all merchandise sold based on FOB shipping point. For merchandise shipped on landed duty paid ("LDP") terms, revenue is recognized at the point of either leaving Customs for direct shipments or at the point of leaving our warehouse where title is transferred, net of an estimate of returned merchandise and discounts. Customers are allowed the rights of return or non-acceptance only upon receipt of damaged products or goods with quality different from shipment samples. We do not undertake any after-sale warranty or any form of price protection.

We often arrange, on behalf of manufacturers, for the purchase of fabric from a single supplier. We have the fabric shipped directly to the cutting factory and invoice the factory for the fabric. Generally, the factories pay us for the fabric with offsets against the price of the finished goods.

Stock-Based Compensation

On January 1, 2006, we adopted SFAS No. 123 (revised 2004), "Share-Based Payment," which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors based on estimated fair values. SFAS No. 123(R) supersedes our previous accounting under Accounting Principles Board Opinion ("ABP") No. 25, "Accounting for Stock Issued to Employees" for periods beginning in fiscal 2006. In March 2005, the SEC issued Staff Accounting Bulletin ("SAB") No. 107 relating to SFAS No. 123(R). We have applied the provisions of SAB No. 107 in our adoption of SFAS No. 123(R).

We adopted SFAS No. 123(R) using the modified prospective transition method, which requires the application of the accounting standard as of January 1, 2006, the first day of our fiscal year 2006. Our financial statements as of and for year ended December 31, 2006 reflect the impact of SFAS 123(R). In accordance with the modified prospective transition method, our financial statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS No. 123(R). Stock-based compensation expense recognized under SFAS No. 123(R) during the year ended December 31, 2006 was $187,000. Basic and dilutive earnings per share for the year ended December 31, 2006 were decreased by $0.01 from $(0.72) to $(0.73) by the additional stock-based compensation recognized.

The fair value of each option granted to employees and directors is estimated on the date of grant using the Black-Scholes option-pricing model ("Black-Scholes model") with the following weighted average assumptions used for grants in 2004, 2005 and 2006: weighted-average volatility factors of the expected market price of our common stock of 0.51 to 0.55 for 2004, 0.55 for 2005 and 0.7 for 2006, weighted-average risk-free interest rates of 3% to 4% for 2004, 4% for 2005 and 5.075% for 2006, dividend yield of 0% for 2004, 2005 and 2006, and weighted-average expected life of the options of 4 years for 2004, 2005 and 6.25 years for 2006.

Income Taxes

As part of the process of preparing our consolidated financial statements, management is required to estimate income taxes in each of the jurisdictions in which we operate. The process involves estimating actual current tax expense along with assessing temporary differences resulting from differing treatment of items for book and tax purposes. These timing differences result in deferred tax assets and liabilities, which are included in our consolidated balance sheets. Management records a valuation allowance to reduce its deferred tax assets to the amount that is more likely than not to be realized. Management has considered future taxable income and ongoing tax planning strategies in assessing the need for the valuation allowance. Increases in the valuation allowance result in additional expense to be reflected within the tax provision in the consolidated statement of operations.

In addition, accruals are also estimated for ongoing audits regarding U.S. Federal tax issues that are currently unresolved, based on our estimate of whether, and the extent to which, additional taxes will be due. We routinely monitor the potential impact of these situations and believe that amounts are properly accrued for. If we ultimately determine that payment of these amounts is unnecessary, we will reverse the liability and recognize a tax benefit during the period in which we determine that the liability is no longer necessary. We will record an additional charge in our provision for taxes in any period we determine that the original estimate of a tax liability is less than we expect the ultimate assessment to be. See Note 12 of the "Notes to Consolidated Financial Statements" for a discussion of current tax matters.

Debt Covenants

Our debt agreements require certain covenants including a minimum level of EBITDA and specified tangible net worth; and required interest coverage ratio and leverage ratio as discussed in Note 9 of the "Notes to Consolidated Financial Statements." If our results of operations erode and we are not able to obtain waivers from the lenders, the debt would be in default and callable by our lenders. In addition, due to cross-default provisions in our debt agreements, substantially all of our long-term debt would become due in full if any of the debt is in default. In anticipation of us not being able to meet the required covenants due to various reasons, we either negotiate for changes in the relative covenants or an advance waiver or reclassify the relevant debt as current. We also believe that our lenders would provide waivers if necessary. However, our expectations of future operating results and continued compliance with other debt covenants cannot be assured and our lenders' actions are not controllable by us. If projections of future operating results are not achieved and the debt is placed in default, we would be required to reduce our expenses, including by curtailing operations, and to raise capital through the sale of assets, issuance of equity or otherwise, any of which could have a material adverse effect on our financial condition and results of operations. As of December 31, 2006, we were in violation of the EBITDA, tangible net worth and leverage ratio covenants and waivers of the defaults were obtained in March 2007 from our lenders.

Derivative Activities

Warrant Derivatives

SFAS No. 133 "Accounting for Derivative Instruments and Hedging Activities" requires measurement of certain derivative instruments at their fair value for accounting purposes. In determining the appropriate fair value, we use the Black-Scholes-Merton Option Pricing Formula (the "Black-Scholes model"). Derivative liabilities are adjusted to reflect fair value at each period end, with any increase or decrease in the fair value being recorded in consolidated statements of operations as adjustments to fair value of derivatives. At December 31, 2006, there was an income of $511,000 recorded as adjustment to fair value of derivative on our consolidated statements of operations. See Note 10 of the "Notes to Consolidated Financial Statements"

Foreign Currency Forward Contract

We source our products in a number of countries throughout the world, as a result, are exposed to movements in foreign currency exchange rates. The primary purpose of our foreign currency hedging activities is to manage the volatility associated with foreign currency purchases of materials in the normal course of business. We utilize derivative financial instruments consist primarily of forward currency contracts. These instruments are intended to protect against exposure related to financing transactions and income from international operations. We do not enter into derivative financial instruments for speculative or trading purposes. We enter into certain foreign currency derivative instruments that do not meet hedge accounting criteria.

SFAS No. 133 requires measurement of certain derivative instruments at their fair value for accounting purposes. All derivative instruments are recorded on our balance sheet at fair value; as a result, we mark to market all derivative instruments. Derivative liabilities are adjusted to reflect fair value at each period end, with any increase or decrease in the fair value being recorded in consolidated statements of operations as adjustments to fair value of derivatives. There were no exchange contracts at December 31, 2005. During the year ended December 31, 2006, we entered into foreign currency forward contracts to hedge against the effect of exchange rate fluctuations on cash flows denominated in foreign currencies and certain inter-company financing transactions. This transaction is undesignated and as such an ineffective hedge. At December 31, 2006, we had one open foreign exchange forward which has a maturity of less than one year. Hedge ineffectiveness resulted in an impact of $196,000 in our consolidated statements of operations as of December 31, 2006

New Accounting Pronouncements

For a description of recent accounting pronouncements including the respective expected dates of adoption and effects on results of operations and financial condition, see Note 1 of the "Notes to Consolidated Financial Statements."

Results of Operations

The following table sets forth, for the periods indicated, certain items in our consolidated statements of income as a percentage of net sales:

	YEARS ENDED DECEMBER 31,		
	2004	2005	2006
Net sales	100.0%	100.0%	100.0%
Cost of sales	86.5	79.1	78.2
Gross profit	13.5	20.9	21.8
Selling and distribution expenses	6.0	5.0	4.7
General and administration expenses	20.6	12.5	11.6
Royalty expenses	0.4	1.7	1.2
Loss on notes receivable-related parties	--	--	11.7
Impairment charges	50.2	--	--
Cumulative translation loss	14.7	--	--
Income (loss) from operations	(78.4)	1.7	(7.4)
Interest expense	(1.8)	(2.2)	(2.6)
Interest income	0.2	1.0	0.5
Minority interest	9.9	0.0	0.0
Interest in income of equity method investee	0.5	0.3	0.0
Other income	4.1	0.1	0.2
Adjustment to fair value of derivative	0.0	0.0	0.1
Other expense	(0.3)	(0.0)	(0.2)
Income (loss) before provision for income taxes	(65.8)	0.9	(9.4)
Provision for income taxes	(1.5)	(0.4)	(0.2)
Net Income (loss)	(67.3)%	0.5%	(9.6)%

Comparison of 2006 to 2005

Net sales increased by $17.8 million, or 8.3%, from $214.6 million in 2005 to $232.4 million in 2006. The increase in net sales was primarily due to increased sales of the private label business, which was $181.2 million in 2006 compared to $159.6 million in 2005, with the increase in 2006 resulting primarily from higher sales to Mothers Work and Charlotte Russe which is a new customer. Private brands sales in 2006 was $51.2 million compared to $55.0 million in 2005 with the decrease resulting primarily from no sales of Gear 7 in 2006, compared to $14.4 million in 2005, and offset by an increase in sales to Macy's Merchandising Group of $11.6 million which included $1.5 million of sublicensing royalty income in 2006.

Gross profit consists of net sales less product costs, direct labor, duty, quota, freight in, brokerage, warehouse handling and markdown. Gross profit for 2006 was $50.6 million, or 21.8% of net sales, compared to $44.9 million, or 20.9 % of net sales for 2005, representing an increase of $5.8 million or 12.8%. The increase in gross profit for 2006 occurred primarily because of an increase in sales volume including $1.5 million of sublicensing royalty income and gross margin. The improvement in gross margin is primarily attributable to the change of relative product mix in private label business and improved sourcing in private brand business in 2006.

Selling and distribution expenses increased by $290,000, or 2.7%, from $10.7 million in 2005 to $11.0 million in 2006. As a percentage of net sales, these variable expenses decreased from 5.0% in 2005 to 4.7% in 2006 due to the increase in sales volume in 2006.

General and administrative expenses increased by $14,000, or 0.1%, from $26.86 million in 2005 to $26.88 million in 2006. As a percentage of net sales, these expenses decreased from 12.5% in 2005 to 11.6% in 2006 due to the increase in sales volume in 2006. Included in general and administrative expenses in 2006 was $187,000 stock-based compensation as compared to no such expense in 2005.

Royalty and marketing allowance expenses decreased by $850,000, or 23.2%, to $2.8 million in 2006 from $3.7 million in 2005. The decrease was primarily due to the royalty payment to House of Dereon in 2005 as compared to no such expense in 2006. As a percentage of net sales, these expenses decreased to 1.2% in 2006 from 1.7% in 2005.

Loss on notes receivable — related parties was $27.1 million or 11.7% of net sales in 2006, compared to no such expense in 2005. During 2006, the purchasers of our Mexico assets ceased providing fabric and are not currently making payments under the notes. We evaluated the recoverability of the notes receivable and recorded a loss on the notes receivable in an amount equal to the outstanding balance less the value of the underlying assets securing the notes. See Note 5 of the "Notes to Consolidated Financial Statements".

Loss from operations was $17.2 million in 2006, or 7.4% of net sales, compared to income from operation of $3.6 million in 2005, or 1.7% of net sales, due to the factors described above.

Interest expense increased by $1.4 million, or 31.0%, from $4.6 million in 2005 to $6.1 million in 2006. As a percentage of net sales, this expense increased to 2.6% in 2006 from 2.2% in 2005. The increase was primarily due to an interest expense of $1.6 million in 2006 related to interest payments and amortization of debt discount arising from the credit facility from Guggenheim Corporate Funding LLC. Included in the interest expense was $1.3 million in 2005 and $1.1 million in 2006 related to interest payments to holders of convertible debentures and amortization of debt discount arising from convertible debentures issued in 2005. Interest income decreased by $900,000, or 43.2%, from $2.1 million in 2005 to $1.2 million in 2006. The decrease was primarily due to the interest earned from the notes receivable related to the sale of our fixed assets in Mexico of $1.9 million in 2005, compared to $901,000 in 2006 due to the purchasers of the Mexico assets discontinuing making payments under the notes. Other income decreased by $19,000, or 5.3%, from $354,000 in 2005 to $336,000 in 2006. Other expenses were $1,000 in 2005, compared to $436,000 in 2006 due to a payment of $400,000 upon the termination of the license agreements with Cynthia Rowley.

In 2005, we allocated $75,000 of profit to minority interest, which consisted of profit shared with the minority partner in the PBG7, LLC. Loss allocated to minority interest in 2006 was $21,000, for its 25% share in the loss.

Interest in income of equity method investee represented our 45% share of equity interest in the owner of the trademark "American Rag CIE" and the operator of American Rag retail stores. Interest in income of equity method investee decreased by $480,000 or 85.8%, from $560,000 in 2005 to $80,000 in 2006. This decrease of interest in income of equity method investee could be attributed to an increase of $230,000 in markdown on slow-moving inventory, an increase in occupancy and depreciation expenses by $546,000 and an increase in personnel expenses by $270,000 due to the opening of a new retail store. While the occupancy, depreciation and personnel expenses of the new store will become a permanent overhead increase, it is not expected that similar amounts of inventory markdown will be required in the current year due to tighter merchandising and inventory control.

Income (loss) before provision for income taxes was $(21.8) million in 2006 and $1.9 million in 2005, representing (9.4)% and 0.9% of net sales, respectively. The increase in loss before provision for income taxes was primarily due to the loss on notes receivable – related parties of $27.1 million recorded in 2006 and the other factors discussed above.

Provision for income taxes was $453,000 in 2006 compared to $927,000 in 2005, representing 0.2% and 0.4% of net sales, respectively.

Net income (loss) was $(22.2) million in 2006 as compared $1.0 million in 2005, representing (9.6)% and 0.5% of net sales, respectively. Included in the $22.2 million net loss in 2006 was a loss on notes receivable — related parties of $27.1 million. There was no such expense in 2005.

Comparison of 2005 to 2004

Net sales increased by $59.2 million, or 38.1%, from $155.5 million in 2004 to $214.6 million in 2005. The increase in net sales was primarily due to increased sales of private brands, which was $55.0 million in 2005 compared to $21.7 million in 2004. Gear 7, JS by Jessica Simpson and Princy by Jessica Simpson recorded significant sales contributions in 2005, as compared to sales of $1.2 million for these brands in 2004. We expect sales of these brands to decline significantly in 2006 due to the discontinuance of the Gear 7 line by K-Mart, the dispute over our continued rights to the Jessica Simpson line and the discontinuation of House of Dereon. Private label sales in 2005 were $159.6 million compared to $133.8 million in 2004, with the increase resulting primarily from increased sales in 2005 to Wal-Mart, Chico's, Mothers Work and Macy's Merchandising Group.

Gross profit for 2005 was $44.9 million, or 20.9% of net sales, compared to $21.0 million, or 13.5 % of net sales, for 2004, representing an increase of $23.9 million or 114.1%. The increase in gross profit for 2005 occurred primarily because of an increase in sales volume and gross margin. The improvement in gross margin is primarily attributable to the change of relative product mix in favor of the higher margin private brands business as compared to private label as well as improved margins in the private label business due to expansion of our business to include more knitwear and woven tops at better margins using private brand product developments.

Selling and distribution expenses increased by $1.4 million, or 15.5%, from $9.3 million in 2004 to $10.7 million in 2005. As a percentage of net sales, these variable expenses decreased from 6.0% in 2004 to 5.0% in 2005 due to the significant increase in sales volume during 2005.

General and administrative expenses decreased by $5.2 million, or 16.3%, from $32.1 million in 2004 to $26.9 million in 2005. The decrease was primarily due to the depreciation and amortization of our Mexico assets of $6.8 million and $1.1 million of severance paid to the Mexican workers in 2004 as compared to no such expense in 2005 after disposition of our fixed assets in Mexico in late 2004. As a percentage of net sales, these expenses decreased from 20.6% in 2004 to 12.5% in 2005.

Royalty and marketing allowance expenses increased by $3.1 million, or 505.8%, to $3.7 million in 2005 from $605,000 in 2004. The increase was primarily due to increased sales under the licensed Alain Weiz and Jessica Simpson brands and a write-off of the remaining balance of $1.2 million of prepaid royalty on House of Dereon in 2005 as a result of termination of our agreement to design, market and sell House of Dereon by Tina Knowles branded apparel in March 2006. See Note 13 of the "Notes to Consolidated Financial Statements." As a percentage of net sales, these expenses increased to 1.7% in 2005 from 0.4% in 2004.

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Impairment charges were $78.0 million in 2004 or 50.2% of net sales, compared to no such expense in 2005. The expense in 2004 was the impairment of long-lived assets of our Mexico operations due to our decision to sell the manufacturing operations in Mexico. See Note 5 of the "Notes to Consolidated Financial Statements."

Cumulative translation loss attributable to liquidated Mexico operations was $22.8 million in 2004, or 14.7% of net sales, compared to no such expense in 2005. We incurred this charge upon the sale of our fixed assets in Mexico in the fourth quarter of 2004.

Income from operations was $3.6 million in 2005, or 1.7% of net sales, compared to loss from operation of $121.8 million in 2004, or 78.4% of net sales, due to the factors described above.

Interest expense increased by $1.7 million, or 61.9%, from $2.9 million in 2004 to $4.6 million in 2005. As a percentage of net sales, this expense increased to 2.2% in 2005 from 1.8% in 2004. The increase was primarily due to an interest expense of $1.3 million in 2005 related to interest payments to holders of convertible debentures and amortization of debt discount arising from issuing convertible debentures, compared to no such expense in 2004. Interest income increased by $1.7 million, or 451.3%, from $378,000 in 2004 to $2.1 million in 2005. The increase was primarily due to the interest earned from the notes receivable related to the sale of our fixed assets in Mexico of $1.9 million in 2005, compared to no such income in 2004. Other income decreased by $6.0 million, or 94.4%, from $6.4 million in 2004 to $354,000 in 2005, due primarily to $5.5 million of lease income received for the lease of our facilities and equipment in Mexico in 2004, compared to no such income in 2005 due to the sale of our Mexico operations in the fourth quarter of 2004. Other expenses were $529,000 in 2004 compared to $1,000 in 2005.

In 2005, we allocated $75,000 of profit to minority interest, which consisted of profit shared with the minority partner in the PBG7, LLC. Loss allocated to minority interests in 2004 was $15.3 million, representing $471,000 attributed to the minority shareholder in United Apparel Ventures, LLC, for its 49.9% share in the loss and $14.8 million attributed to the minority shareholder in Tarrant Mexico for its 25% share in the loss.

Interest in income of equity method investee represented our 45% share of equity interest in the owner of the trademark “American Rag CIE” and the operator of American Rag retail stores. Interest in income of equity method investee declined by 27.3% from $770,000 in 2004 to $560,000 in 2005 due to a general increase in overhead expenses. The more significant items included increase in personnel expenses of $128,000 and outsourced information technology support of $112,000.

Income before provision for income taxes was $1.9 million in 2005 and loss before provision for income taxes was $102.3 million in 2004, representing 0.9% and (65.8)% of net sales, respectively. The increase in income before provision for income taxes was due to the factors discussed above.

Provision for income taxes was $927,000 in 2005 compared to $2.3 million in 2004, representing 0.4% and 1.5% of net sales, respectively.

Net income was $1.0 million in 2005 as compared to net loss of $104.7 million in 2004, representing 0.5% and (67.3)% of net sales, respectively. Included in the $104.7 million loss in 2004 were charges of $78.0 million for the impairment of long-lived assets and $22.8 million of cumulative translation loss attributable to liquidated Mexico operations. There were no such charges in 2005.

Quarterly Results of Operations

The following table sets forth, for the periods indicated, certain items in our consolidated statements of income in millions of dollars and as a percentage of net sales:

	QUARTER ENDED							
	MAR. 31 2005	JUN. 30 2005	SEP. 30 2005	DEC. 31 2005	MAR. 31 2006	JUN. 30 2006	SEP. 30 2006	DEC. 31 2006
Net Sales	$ 44.8	$ 50.5	$ 69.6	$ 49.7	$ 61.3	$ 59.1	$ 54.6	$ 57.4
Gross profit	8.9	11.5	14.5	10.0	12.5	12.7	11.8	13.6
Operating income (loss)	0.2	1.5	3.0	(1.1)	1.6	2.6	(24.7)	3.3
Net income (loss)	(0.1)	0.9	1.7	(1.5)	0.8	0.6	(25.3)	1.7

	QUARTER ENDED							
	MAR. 31 2005	JUN. 30 2005	SEP. 30 2005	DEC. 31 2005	MAR. 31 2006	JUN. 30 2006	SEP. 30 2006	DEC. 31 2006
Net sales	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Gross profit	20.0	22.7	20.9	20.0	20.4	21.4	21.6	23.8
Operating income (loss)	0.5	2.8	4.3	(2.1)	2.7	4.4	(45.3)	5.7
Net income (loss)	(0.2)	1.7	2.5	(3.0)	1.4	1.0	(46.4)	2.9

As is typical for us, quarterly net sales fluctuated significantly because our customers typically place bulk orders with us, and a change in the number of orders shipped in any one period may have a material effect on the net sales for that period.

Liquidity and Capital Resources

Our liquidity requirements arise from the funding of our working capital needs, principally inventory, finished goods shipments-in-transit, work-in-process and accounts receivable, including receivables from our contract manufacturers that relate primarily to fabric we purchase for use by those manufacturers. Our primary sources for working capital and capital expenditures are cash flow from operations, borrowings under our bank and other credit facilities, issuance of long-term debt, sales of equity and debt securities, and vendor financing. In the near term, we expect that our operations and borrowings under bank and other credit facilities will provide sufficient cash to fund our operating expenses, capital expenditures and interest payments on our debt. In the long-term, we expect to use internally generated funds and external sources to satisfy our debt and other long-term liabilities.

Our liquidity is dependent, in part, on customers paying on time. Any abnormal chargebacks or returns may affect our source of short-term funding. Any changes in credit terms given to major customers may have an impact on our cash flow. Suppliers' credit is another major source of short-term financing and any adverse changes in their terms will have negative impact on our cash flow.

Other principal factors that could affect the availability of our internally generated funds include:

- o deterioration of sales due to weakness in the markets in which we sell our products;
- o decreases in market prices for our products;
- o increases in costs of raw materials; and
- o changes in our working capital requirements.

Principal factors that could affect our ability to obtain cash from external sources include:

- o financial covenants contained in our current or future bank and debt facilities; and
- o volatility in the market price of our common stock or in the stock markets in general.

Certain of our private brands product lines are generally associated with higher selling, general and administrative expenses, due to significant design, development, and marketing costs compared to our private label business.

Cash flows for the years ended December 31, 2004, 2005 and 2006 were as follows (dollars in thousands):

CASH FLOWS:	**2004**	**2005**	**2006**
Net cash provided by (used in) operating activities	$ 12,168	$ (12,900)	$ 15,047
Net cash provided by (used in) investing activities	$ 1,250	$ 3,555	$ (5,071)
Net cash provided by (used in) financing activities	$ (15,552)	$ 9,772	$ (10,713)

Net cash provided by operating activities was $15.0 million in 2006, as compared to net cash used in operating activities in 2005 of $12.9 million and net cash provided by operating activities in 2004 of $12.2 million. Net cash provided by operating activities in 2006 resulted primarily from a net loss of $22.2 million and a decrease of $10.6 million in accounts payable, offset by $27.1 million of loss on notes receivable — related parties, $3.0 million of depreciation and amortization of fixed assets and deferred financing cost, a decrease of $13.3 million in inventory and $6.5 million in accounts receivable. The decrease in inventory was primarily due to the increase in sales in 2006, the decrease in accounts payable resulted from the pay down of payables and the decrease in accounts receivable was due to increased collections.

During 2006, net cash used in investing activities was $5.1 million, as compared to net cash provided by investing activities of $3.6 million in 2005 and $1.3 million in 2004. Cash used in investing activities in 2006 included approximately $5.0 million in a deposit and $1.1 million in due diligence fees incurred in connection with our pending acquisition of the Buffalo Group, offset by $1.1 million of collection on notes receivable.

During 2006, net cash used in financing activities was $10.7 million as compared to net cash provided by financing activities of $9.8 million in 2005 and net cash used in financing activities of $15.6 million in 2004. Net cash used in financing activities in 2006 resulted primarily from net repayments of our long-term obligations and financing cost of $19.2 million, and repayments of borrowings from convertible debentures of $6.9 million, offset by financing of $15.5 million under our credit facility with Guggenheim Corporate Funding LLC.

Contractual Obligations and Commercial Commitments

Following is a summary of our contractual obligations and commercial commitments available to us as of December 31, 2006 (in millions):

Contractual Obligations	Total	Less than 1 year	Between 2-3 years	Between 4-5 years	After 5 years
	Payments Due By Period				
Long-term debt(1)	$ 44.4	$ 23.2	$ 3.8	$ 17.4	$ --
Operating leases	$ 9.2	$ 1.8	$ 2.6	$ 2.3	$ 2.5
Minimum royalties(2)	$ 14.5	$ 6.0	$ 2.7	$ 2.5	$ 3.3
Purchase commitment	$ 45.4	$ 10.4	$ 10.0	$ 10.0	$ 15.0
Total Contractual Cash Obligations	$ 113.5	$ 41.4	$ 19.1	$ 32.2	$ 20.8

(1) Includes interest on long-term debt obligations. Based on outstanding borrowings as of December 31, 2006, and assuming all such indebtedness remained outstanding during 2006 and the interest rates remained unchanged, we estimate that our interest cost on long-term debt would be approximately $9.3 million.

(2) Includes minimum royalties of $6.1 million under the agreement with the licensor of the Jessica Simpson brands.

Other Commercial Commitments Available to Us	Total Amounts Committed to Us	Less than 1 year	Between 2-3 years	Between 4-5 years	After 5 years
		Amount of Commitment Expiration per Period			
Lines of credit	$ 80.0	$ 80.0	--	--	--
Letters of credit (within lines of credit)	$ 25.0	$ 25.0	--	--	--
Total Commercial Commitments	$ 80.0	$ 80.0	--	--	--

On June 13, 2002, we entered into a letter of credit facility of $25 million with UPS Capital Global Trade Finance Corporation (“UPS”). Under this facility, we could arrange for the issuance of letters of credit and acceptances. The facility was collateralized by the shares and debentures of all of our subsidiaries in Hong Kong. In addition to the guarantees provided by us and our subsidiaries, Fashion Resource (TCL) Inc. and Tarrant Luxembourg Sarl, Gerard Guez, our Chairman and Interim Chief Executive Officer, also signed a guarantee of $5 million in favor of UPS to secure this facility. Additionally, Gerard Guez pledged to UPS 4.6 million shares of our common stock held by Mr. Guez to secure the obligations under the credit facility. On June 9, 2006, we completed the pay-off of all remaining amounts due under the letter of credit facility with UPS. As a result of the payment of these obligations, the letter of credit facility was terminated and all collateral released. There was no prepayment penalty under this arrangement. As of December 31, 2006, $0 was outstanding under this facility with UPS.

On December 31, 2004, our Hong Kong subsidiaries entered into a loan agreement with UPS pursuant to which UPS made a $5 million term loan, the proceeds of which were used to repay $5 million of indebtedness owed to UPS under the letter of credit of facility. The principal amount of this loan was due and payable in 24 equal monthly installments of approximately $208,333 each, plus interest equivalent to the “prime rate” plus 2% commencing on February 1, 2005. The obligations under the loan agreement were collateralized by the same security interests and guarantees provided under our letter of credit facility with UPS. Additionally, the term loan was secured by two promissory notes payable to Tarrant Luxembourg Sarl in the amounts of $2,550,000 and $1,360,000 and a pledge by Gerard Guez, of 4.6 million shares of our common stock. On June 9, 2006, we completed the pay-off of all remaining amounts due under the term loan agreement with UPS. As a result of the payment of these obligations, the term loan agreement was terminated and all collateral released. There was no prepayment penalty under this arrangement. As of December 31, 2006, $0 was outstanding under this loan arrangement with UPS.

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Since March 2003, DBS Bank (Hong Kong) Limited (“DBS”) had made available a letter of credit facility of up to HKD 20 million (equivalent to US $2.6 million) to our subsidiaries in Hong Kong. This was a demand facility and was secured by the pledge of our office property, which is owned by Gerard Guez, our Chairman and Interim Chief Executive Officer, and Todd Kay, our Vice Chairman, and by our guarantee. The letter of credit facility was increased to HKD 30 million (equivalent to US $3.9 million) in June 2004. In September 2006, a tax loan for HKD 8.438 million (equivalent to US $1.1 million) was also made available to our Hong Kong subsidiaries and bears interest at the rate equal to the Hong Kong prime rate plus 1% and are subject to the same security. It bore interest at 9% per annum at December 31, 2006. As of December 31, 2006, $1.0 million was outstanding under this tax loan.

In June 2006, our subsidiaries in Hong Kong, Tarrant Company Limited, Marble Limited and Trade Link Holdings Limited, entered into a new credit facility with DBS. Under this facility, we may arrange for letters of credit and acceptances. The maximum amount our Hong Kong subsidiaries may borrow under this facility at any time is US $25 million. The interest rate under the letter of credit facility is equal to the Standard Bills Rate quoted by DBS minus 0.5% if paid in Hong Kong Dollars, which the interest rate was 8.5% per annum at December 31, 2006, or the Standard Bills Rate quoted by DBS plus 0.5% if paid in any other currency, which the interest rate was 8.6% per annum at December 31, 2006. This is a demand facility and is secured by a security interest in all the assets of the Hong Kong subsidiaries, by a pledge of our office property where our Hong Kong office is located, which is owned by Gerard Guez and Todd Kay and by our guarantee. The DBS facility includes customary default provisions. In addition, we are subject to certain restrictive covenants, including that we maintain a specified tangible net worth, and a minimum level of EBITDA at December 31, 2006, interest coverage ratio, leverage ratio and limitations on additional indebtedness. As of December 31, 2006, we were in violation with the EBITDA, tangible net worth and leverage ratio covenants and a waiver was obtained on March 19, 2007. As of December 31, 2006, $12.5 million was outstanding under this facility. In addition, $4.1 million of open letters of credit was outstanding and $7.4 million was available for future borrowings as of December 31, 2006.

On October 1, 2004, we amended and restated our previously existing credit facility with GMAC Commercial Finance Credit, LLC (“GMAC CF”) by entering into a new factoring agreement with GMAC CF. The amended and restated agreement (the factoring agreement) extended the expiration date of the facility to September 30, 2007 and added as parties our subsidiaries Private Brands, Inc and No! Jeans, Inc. In addition, in connection with the factoring agreement, our indirect majority-owned subsidiary PBG7, LLC entered into a separate factoring agreement with GMAC CF. Pursuant to the terms of the factoring agreement, we and our subsidiaries agree to assign and sell to GMAC CF, as factor, all accounts which arise from our sale of merchandise or rendition of service created on a going forward basis. At our request, GMAC CF, in its discretion, may make advances to us up to the lesser of (a) up to 90% of our accounts on which GMAC CF has the risk of loss or (b) $40 million, minus in each case, any amount owed by us to GMAC CF. In May 2005, we amended our factoring agreement with GMAC CF to permit our subsidiaries party thereto and us, to borrow up to the lesser of $3 million or 50% of the value of eligible inventory. In connection with this amendment, we granted GMAC CF a lien on certain of our inventory located in the United States. On January 23, 2006, we further amended our factoring agreement with GMAC CF to increase the amount we might borrow against inventory to the lesser of $5 million or 50% of the value of eligible inventory. The $5 million limit was reduced to $4 million on April 1, 2006.

On June 16, 2006, we expanded our credit facility with GMAC CF by entering into a new Loan and Security Agreement and amending and restating our previously existing Factoring Agreement with GMAC CF. UPS Capital Corporation is also a lender under the Loan and Security Agreement. This is a revolving credit facility and has a term of 3 years. The amount we may borrow under this credit facility is determined by a percentage of eligible accounts receivable and inventory, up to a maximum of $55 million, and includes a letter of credit facility of up to $4 million. Interest on outstanding amounts under this credit facility is payable monthly and accrues at the rate of the “prime rate” plus 0.5%. Our obligations under the GMAC CF credit facility are secured by a lien on substantially all our domestic assets, including a first priority lien on our accounts receivable and inventory. This credit facility contains customary financial covenants, including covenants that we maintain minimum levels of EBITDA and interest coverage ratios and limitations on additional indebtedness. This facility includes customary default provisions, and all outstanding obligations may become immediately due and payable in the event of a default. The facility bore interest at 8.75% per annum at December 31, 2006. As of December 31, 2006, we were in violation with the EBITDA covenant and a waiver was obtained on March 23, 2007. A total of $19.6 million was outstanding with respect to receivables factored under the GMAC CF facility at December 31, 2006.

The amount we can borrow under the factoring facility with GMAC is determined based on a defined borrowing base formula related to eligible accounts receivable. A significant decrease in eligible accounts receivable due to the aging of receivables, can have an adverse effect on our borrowing capabilities under our credit facility, which may adversely affect the adequacy of our working capital. In addition, we have typically experienced seasonal fluctuations in sales volume. These seasonal fluctuations result in sales volume decreases in the first and fourth quarters of each year due to the seasonal fluctuations experienced by the majority of our customers. During these quarters, borrowing availability under our credit facility may decrease as a result of decrease in eligible accounts receivables generated from our sales.

On June 16, 2006, we entered into a Credit Agreement with certain lenders and Guggenheim Corporate Funding LLC (“Guggenheim”), as administrative agent and collateral agent for the lenders. This credit facility provides for borrowings of up to $65 million. This facility consists of an initial term loan of up to $25 million, of which we borrowed $15.5 million at the initial funding, to be used to repay certain existing indebtedness and fund general operating and working capital needs. An additional term loan of up to $40 million will be available under this facility to finance acquisitions acceptable to Guggenheim. All amounts under the term loans become due and payable in December 2010. Interest under this facility is payable monthly, with the interest rate equal to the LIBOR rate plus an applicable margin based on our debt leverage ratio (as defined in the credit agreement). Our obligations under the Guggenheim credit facility are secured by a lien on substantially all of our assets and our domestic subsidiaries, including a pledge of the equity interests of our domestic subsidiaries and 65% of our Luxembourg subsidiary.

This credit facility contains customary financial covenants, including covenants that we maintain minimum levels of EBITDA and interest coverage ratios and limitations on additional indebtedness.

In connection with Guggenheim credit facility, on June 16, 2006, we issued the lenders under this facility warrants to purchase up to an aggregate of 3,857,143 shares of our common stock. These warrants have a term of 10 years. These warrants are exercisable at a price of $1.88 per share with respect to 20% of the shares, $2.00 per share with respect to 20% of the shares, $3.00 per share with respect to 20% of the shares, $3.75 per share with respect to 20% of the shares and $4.50 per share with respect to 20% of the shares. The exercise prices are subject to adjustment for certain dilutive issuances pursuant to the terms of the warrants. 357,143 shares of the warrants will not become exercisable unless and until a specified portion of the initial term loan is actually funded by the lenders. The warrants were evaluated under SFAS No. 133 and Emerging Issues Task Force ("EITF") No. 00-19 "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock" and determined to be a derivative instrument due to certain registration rights. As such, the warrants excluding the ones not exercisable were valued at $4.9 million using the Black-Scholes model with the following assumptions: risk-free interest rate of 5.1%; dividend yields of 0%; volatility factors of the expected market price of our common stock of 0.70; and contractual term of ten years. We also paid to Guggenheim 2.25% of the committed principal amount of the loans which was $563,000 on June 16, 2006. The $563,000 fee paid to Guggenheim is included in the deferred financing cost, and the value of the warrants to purchase 3.5 million shares of our common stock of $4.9 million is recorded as debt discount, both of them are amortized over the life of the loan. As of December 31, 2006, $654,000 was amortized.

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Durham Capital Corporation ("Durham") acted as our advisor in connection with the Guggenheim credit facility. As compensation for its services, we agreed to pay Durham a cash fee in an amount equal to 1% of the committed principal amount of the loans under the Guggenheim credit facility. As a result, $250,000 was paid on June 16, 2006. In addition, we issued Durham a warrant to purchase 77,143 shares of our common stock. This warrant has a term of 10 years and is exercisable at a price of $1.88 per share, subject to adjustment for certain dilutive issuances. 7,143 shares of this warrant will not become exercisable unless and until a specified portion of the initial term loan is actually funded by the lenders. The warrants were evaluated under SFAS No. 133 and EITF No. 00-19 and determined to be a derivative instrument due to certain registration rights. As such, the warrants excluding the ones not exercisable were valued at $105,000 using the Black-Scholes model with the following assumptions: risk-free interest rate of 5.1%; dividend yields of 0%; volatility factors of the expected market price of our common stock of 0.70; and contractual term of ten years. The $250,000 fee paid to Durham and the value of the warrants to purchase 70,000 shares of our common stock of $105,000 is included in the deferred financing cost, and is amortized over the life of the loan. As of December 31, 2006, $43,000 was amortized.

The Guggenheim facility bore interest at 12.36% per annum at December 31, 2006. As of December 31, 2006, we were in violation with the EBITDA covenant and a waiver was obtained on March 23, 2007. A total of $11.2 million, net of $4.3 million of debt discount, was outstanding under this facility at December 31, 2006.

As of June 30, 2006, the warrants were being accounted for as a liability pursuant to the provisions of SFAS No. 133 and EITF No. 00-19. This was because we granted the warrant holders certain registration rights that were outside our control. In accordance with SFAS No. 133, the warrants were being valued at each reporting period. Changes in fair value were recorded as adjustment to fair value of derivative in the statements of operations. The outstanding warrants were fair valued on June 16, 2006, the date of the transaction, at $5.0 million and we, in accordance with SFAS No. 133, revaluated the warrants on June 30, 2006 at the closing stock price on June 30, 2006 to $5.2 million; as a result, an expense of $218,000 was recorded as an adjustment to fair value of derivative on our consolidated statements of operations. On August 11, 2006, the registration rights agreement relating to the warrants was amended to provide that if we were unable to file or have the registration statement declared effective by the required deadlines, we would be required to pay the warrant holders cash payments as partial liquidated damages each month until the registration statement was filed and/or declared effective. The liquidated damages payable by us to the warrant holders are limited to 20% of the purchase price of the shares underlying the warrants, which we determined to be a reasonable discount for restricted stock as compared to registered stock. As a result of amending the registration rights relating to the warrants on August 11, 2006, the warrants were reclassified from debt to equity in accordance with EITF No. 00-19 in the third quarter of 2006. The outstanding warrants were revaluated on August 11, 2006 at the closing stock price on August 11, 2006 to $4.5 million; as a result, income of $729,000 was recorded as an adjustment to fair value of derivative on our consolidated statements of operations. As such, a net gain of $511,000 was recognized in our statements of operations as an adjustment to fair value of derivative in 2006.

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The credit facilities with GMAC CF and Guggenheim include cross-default clauses subject to certain conditions. An event of default under the GMAC CF facility would constitute an event of default under the Guggenheim facility entitling Guggenheim to demand payment in full of all outstanding amounts under its facility. An event of default under the Guggenheim facility, under circumstances where Guggenheim has accelerated the debt or has exercised any other remedy available to Guggenheim which constitutes a Lien Enforcement Action under its Intercreditor Agreement with GMAC CF, would entitle GMAC CF to demand payment in full of all outstanding amounts under its debt facilities.

On December 14, 2004, we completed a $10 million financing through the issuance of (i) 6% Secured Convertible Debentures ("Debentures") and (ii) warrants to purchase up to 1,250,000 shares of our common stock. Prior to maturity, the investors could convert the Debentures into shares of our common stock at a price of $2.00 per share. The warrants have a term of five years and an exercise price of $2.50 per share. The warrants were valued at $866,000 using the Black-Scholes model with the following assumptions: risk-free interest rate of 4%; dividend yields of 0%; volatility factors of the expected market price of our common stock of 0.55; and an expected life of four years. The Debentures bore interest at a rate of 6% per annum and have a term of three years. We could elect to pay interest on the Debentures in shares of our common stock if certain conditions are met, including a minimum market price and trading volume for our common stock. The Debentures contained customary events of default and permit the holder thereof to accelerate the maturity if the full principal amount together with interest and other amounts owing upon the occurrence of such events of default. The Debentures were secured by a subordinated lien on certain of our accounts receivable and related assets. The closing market price of our common stock on the closing date of the financing was $1.96. The Debentures were thus valued at $8,996,000, resulting in an effective conversion price of $1.799 per share. The intrinsic value of the conversion option of $804,000 was being amortized over the life of the loan. The value of the warrants of $866,000 and the intrinsic value of the conversion option of $804,000 were netted from the $10 million presented as the convertible debentures, net on our accompanying balance sheets at December 31, 2004.

The placement agent in the financing, received compensation for its services in the amount of $620,000 in cash and issuance of five year warrants to purchase up to 200,000 shares of our common stock at an exercise price of $2.50 per share. The warrants to purchase 200,000 shares of our common stock were valued at $138,000 using the Black-Scholes model with the following assumptions: risk-free interest rate of 4%; dividend yields of 0%; volatility factors of the expected market price of our common stock of 0.55; and an expected life of four years. The financing cost paid to the placement agent of $620,000, and the value of the warrants to purchase 200,000 shares of our common stock of $138,000 were included in the deferred financing cost, net on our accompanying balance sheets and was amortized over the life of the loan.

In June 2005, holders of our Debentures converted an aggregate of $2.3 million of Debentures into 1,133,687 shares of our common stock. In August 2005, holders of our Debentures converted an aggregate of $820,000 of Debentures into 410,000 shares of our common stock. The Debentures were converted at the option of the holders at a price of $2.00 per share. Debt discount of $248,000 related to the intrinsic value of the conversion option of $804,000 was expensed upon the conversion. Of the $620,000 financing cost paid to the placement agent, $191,000 was expensed upon the conversion. The intrinsic value of the conversion option, and the value of the warrant amortized in the 2006 was $237,000. Total deferred financing cost amortized in 2006 was $95,000. Total interest paid to the holders of the Debentures in 2006 was $198,000. On June 26, 2006, we paid off the remaining balance of the outstanding Debentures of $6.9 million plus all accrued and unpaid interest and a prepayment penalty of $171,000. As a result of the repayment, the Debentures were terminated effective June 26, 2006. Upon paying off the Debentures, debt discount of $278,000 related to the intrinsic value of the conversion option of $804,000 was expensed, and of the $620,000 financing cost paid to the placement agent, $214,000 was expensed. The remaining value of the warrants to holders of our Debentures of $433,000 and warrants to the placement agent of $69,000 was also expensed.

On January 19, 2006, we borrowed $4.0 million from Max Azria pursuant to the terms of a promissory note, which amount bore interest at the rate of 5.5% per annum and was payable in weekly installments of $200,000 beginning on March 1, 2006. This was an unsecured loan. We paid off the remaining balance of this loan in July 2006. As of December 31, 2006, $0 was outstanding under this loan.

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We had three equipment loans outstanding during 2006. One of these equipment loans bore interest at 6% payable in installments through 2009, which we paid off in January 2006. The second loan bears interest at 15.8% payable in installment through 2007 and the third loan bears interest at 6.15% payable in installment through 2007. In August 2006, we entered into a new auto loan that bears interest at 4.75% payable in installment through 2008. As of December 31, 2006, $38,000 was outstanding under the three remaining loans.

From time to time, we open letters of credit under an uncommitted line of credit from Aurora Capital Associates which issues these letters of credits out of Israeli Discount Bank. As of December 31, 2006, $190,000 was outstanding under this facility (classified above under import trade bills payable) and $532,000 of letters of credit was open under this arrangement. We pay a commission fee of 2.25% on all letters of credits issued under this arrangement.

The effective interest rates on short-term bank borrowing as of December 31, 2005 and 2006 were 7.8% and 10.9%, respectively.

We have financed our operations from our cash flow from operations, borrowings under our bank and other credit facilities, issuance of long-term debt, and sales of equity and debt securities. Our short-term funding relies very heavily on our major customers, banks and suppliers. From time to time, we have had temporary over-advances from our banks. Any withdrawal of support from these parties will have serious consequences on our liquidity.

From time to time in the past, we borrowed funds from, and advanced funds to, certain officers and principal shareholders, including Gerard Guez and Todd Kay. See disclosure under "-Related Party Transactions" below.

The Internal Revenue Service has proposed adjustments to our Federal income tax returns to increase our income tax payable for the years ended December 31, 1996 through 2001. In addition, in July 2004, the IRS initiated an examination of our Federal income tax return for the year ended December 31, 2002. In March 2005, the IRS proposed an adjustment to our taxable income of approximately $9 million related to similar issues identified in their audit of the 1996 through 2001 federal income tax returns. We believe that we have meritorious defenses to and intend to vigorously contest the proposed adjustments made to our federal income tax returns for the years ended 1996 through 2002. This adjustment would also result in additional state taxes, penalties and interest. We believe that we have meritorious defenses to and intend to vigorously contest the proposed adjustments. If the proposed adjustments are upheld through the administrative and legal process, they could have a material impact on our earnings and, in particular, cash flow. We may not have an adequate cash reserve to pay the final adjustments resulting from the IRS examination. As a result, we may be required to arrange for payments over time or raise additional capital in order to meet these obligations. We believe we have provided adequate reserves for any reasonably foreseeable outcome related to these matters on the consolidated balance sheets under the caption “Income Taxes.” The maximum amount of loss in excess of the amount accrued in the financial statements is $8.3 million. We do not believe that the adjustments, if any, arising from the IRS examination, will result in an additional income tax liability beyond what is recorded in the accompanying consolidated balance sheets.

We may seek to finance future capital investment programs through various methods, including, but not limited to, borrowings under our bank credit facilities, issuance of long-term debt, sales of equity securities, leases and long-term financing provided by the sellers of facilities or the suppliers of certain equipment used in such facilities. As described above, in December 2006, we entered into a definitive stock and asset purchase agreement to acquire The Buffalo. If the acquisition is approved by our shareholders and is consummated pursuant to the terms of the agreement, we will be required to issue 13 million exchangeable shares of our Canadian subsidiary to the sellers (which are exchangeable in shares of our common stock on a one-for-one basis), incur additional long-term and medium-term debt of approximately $40 million to pay the cash portion of the purchase price, issue promissory notes of $15 million to sellers, and assume certain debt of The Buffalo Group. In addition, we may have to pay additional $12 million in cash earn-out payments to the sellers over a four year period, contingent upon achievement of the acquired business of specified earnings targets. We believe we have sufficient internal resources and borrowing capability to cover all the related expenses.

We do not believe that the moderate levels of inflation in the United States in the last three years have had a significant effect on net sales or profitability.

Related Party Transactions

We lease our principal offices and warehouse located in Los Angeles, California from GET and office space in Hong Kong from Lynx International Limited. GET and Lynx International Limited are each owned by Gerard Guez, our Chairman and Interim Chief Executive Officer, and Todd Kay, our Vice Chairman. We believe, at the time the leases were entered into, the rents on these properties were comparable to then prevailing market rents. During the first seven months of 2006, our Los Angeles offices and warehouse were leased on a month to month basis. On August 1, 2006, we entered into a lease agreement with GET for the Los Angeles offices and warehouse, which lease has a term of five years with an option to renew for an additional five year term. On February 1, 2007, we entered into a one year lease agreement with Lynx International Limited for our office space and warehouse in Hong Kong. We paid $1,330,000, $1,019,000 and $1,076,000, respectively, in 2004, 2005 and 2006 in rent for office and warehouse facilities at these locations. On May 1, 2006, we sublet a portion of our executive office in Los Angeles, California and our sales office in New York to Seven Licensing Company, LLC (“Seven Licensing”) for a monthly payment of $25,000 on a month to month basis. Seven Licensing is beneficially owned by Gerard Guez. We received $200,000 in rental income from this sublease in the year ended December 31, 2006.

On October 16, 2003, we leased to affiliates of Mr. Kamel Nacif, a shareholder at the time of the transaction, for a substantial portion of our manufacturing facilities and operations in Mexico including real estate and equipment. We leased our twill mill in Tlaxcala, Mexico, and our sewing plant in Ajalpan, Mexico, for a period of 6 years and for an annual rental fee of $11 million. In connection with this lease transaction, we also entered into a management services agreement pursuant to which Mr. Nacif’s affiliates agreed to manage the operation of our remaining facilities in Mexico in exchange for the use of such facilities. The term of the management services agreement was also for a period of 6 years. In 2004, $5.5 million of lease income was recorded in other income. We agreed to purchase annually, six million yards of fabric manufactured at the facilities leased and/or operated by Mr. Nacif’s affiliates at market prices to be negotiated. We purchased $5.3 million of fabric under this agreement in 2004.

In August 2004, we entered into an Agreement for Purchase of Assets with affiliates of Mr. Kamel Nacif, a shareholder at the time of the transaction, which agreement was amended in October 2004. Pursuant to the agreement, as amended, on November 30, 2004, we sold to the purchasers substantially all of our assets and real property in Mexico, including the equipment and facilities we previously leased to Mr. Nacif’s affiliates in October 2003, for an aggregate purchase price consisting of: a) $105,400 in cash and $3,910,000 by delivery of unsecured promissory notes bearing interest at 5.5% per annum; and b) $40,204,000, by delivery of secured promissory notes bearing interest at 4.5% per annum, with payments due on December 31, 2005 and every year thereafter until December 31, 2014. The secured promissory notes are payable in partial or total amounts anytime prior to the maturity of each note. As of September 30, 2006, the outstanding balance of the notes and interest receivables were $41.1 million prior to the reserve. Historically, we have placed orders for purchases of fabric from the purchasers pursuant to the purchase commitment agreement we entered into at the time of the sale of the Mexico assets, and we have satisfied our payment obligations for the fabric by offsetting the amounts payable against the amounts due to us under the notes. However, during 2006, the purchasers ceased providing fabric and are not currently making payments under the notes. We further evaluated the recoverability of the notes receivable and recorded a loss on the notes receivable in the third quarter of 2006 in an amount equal to the outstanding balance less the value of the underlying assets securing the notes. The loss was estimated to be approximately $27.1 million, resulting in a notes receivable balance at September 30, 2006 of approximately $14 million. We will continue to pursue payments on the notes receivable and believe the remaining $14 million balance at December 31, 2006 is realizable.

Upon consummation of the sale of our Mexico assets, we entered into a purchase commitment agreement with the purchasers, pursuant to which we agreed to purchase annually over the ten-year term of the agreement, $5 million of fabric manufactured at our former facilities acquired by the purchasers at negotiated market prices. This agreement replaced a previously existing purchase commitment agreement with Mr. Nacif's affiliates. We purchased $6.4 million of fabric, of which $2.4 million was paid in cash and $4.0 million was offset against the notes receivable principal and accrued interest on the note receivable from the affiliates of Mr. Kamel Nacif in 2005. We did not purchase any fabric in 2006. Net amount due from Mr. Kamel Nacif and his affiliates was $236,000 and $116,000 as of December 31, 2005 and 2006, respectively.

From time to time in the past, we had advanced funds to Mr. Guez. These were net advances to Mr. Guez or payments paid on his behalf before the enactment of the Sarbanes-Oxley Act in 2002. The promissory note documenting these advances contains a provision that the entire amount together with accrued interest is immediately due and payable upon our written demand. The greatest outstanding balance of such advances to Mr. Guez during 2006 was approximately $2,279,000. At December 31, 2006, the entire balance due from Mr. Guez totaling $2.2 million was reflected as a reduction of shareholders' equity. All amounts due from Mr. Guez bore interest at the rate of 7.75% during the period. Total interest paid by Mr. Guez was $370,000, $209,000 and $171,000 for the years ended December 31, 2004, 2005 and 2006, respectively. Mr. Guez paid expenses on our behalf of approximately $400,000, $397,000 and $299,000 for the years ended December 31, 2004, 2005 and 2006, respectively, which amounts were applied to reduce accrued interest and principal on Mr. Guez's loan. These amounts included fuel and related expenses incurred by 477 Aviation, LLC, a company owned by Mr. Guez, when our executives used this company's aircraft for business purposes. Since the enactment of the Sarbanes-Oxley Act in 2002, no further personal loans (or amendments to existing loans) have been or will be made to officers or directors of Tarrant.

On July 1, 2001, we formed an entity to jointly market, share certain risks and achieve economies of scale with Azteca Production International, Inc. ("Azteca"), called United Apparel Ventures, LLC ("UAV"). Azteca is owned by the brothers of Gerard Guez. This entity was created to coordinate the production of apparel for a single customer of our branded business. UAV is owned 50.1% by Tag Mex, Inc., our wholly owned subsidiary, and 49.9% by Azteca. Results of the operation of UAV have been consolidated into our results since July 2001 with the minority partner's share of all gains and loses eliminated through the minority interest line in our financial statements. Due to the restructuring of our Mexico operations, we discontinued manufacturing for UAV customers in the second quarter of 2004. We have been consolidating 100% of the results of the operation of UAV into our results since 2005. Two and one half percent of gross sales as management fees were paid in 2004 to each of the members of UAV, per the operating agreement. The management fees paid to Azteca in 2004 was $179,000. We purchased $11.5 million, $135,000 and $1.1 million of finished goods, fabric and service from Azteca and its affiliates for the years ended December 31, 2004, 2005 and 2006, respectively. Our total sales of fabric and service to Azteca in 2004, 2005 and 2006 were $1.0 million, $88,000 and $9,000, respectively.

Since June 2003, UAV had been selling to Seven Licensing, jeans wear bearing the brand "Seven7", which was ultimately purchased by Express. In the third quarter of 2004, in order to strengthen our own private brand business, we decided to discontinue sourcing for Seven7. Total sales to Seven Licensing in the year ended December 31, 2004 were $2.6 million. On September 1, 2006, our subsidiary in Hong Kong, Tarrant Company Limited, entered into an agreement with Seven Licensing to be its buying agent to source and purchase apparel merchandise. Total sales to Seven Licensing during the year ended December 31, 2006 were $4.4 million.

At December 31, 2006, Messrs. Guez and Kay beneficially owned 488,400 and 1,003,500 shares, respectively, of common stock of Tag-It Pacific, Inc. ("Tag-It"), collectively representing 8.1% of Tag-It's common stock. Tag-It is a provider of brand identity programs to manufacturers and retailers of apparel and accessories. Tag-It assumed the responsibility for managing and sourcing all trim and packaging used in connection with products manufactured by or on our behalf in Mexico. Due to the restructuring of our Mexico operations, Tag-It no longer manages our trim and packaging requirements. We purchased $1.0 million, $450,000 and $205,000 of trim from Tag-It during the years ended December 31, 2004, 2005 and 2006. Our sales of garment accessories to Tag-It for the year ended December 31, 2006 were $39,000.

We believe that each of the transactions described above has been entered into on terms no less favorable to us than could have been obtained from unaffiliated third parties. We have adopted a policy that any transactions between us and any of our affiliates or related parties, including our executive officers, directors, the family members of those individuals and any of their affiliates, must (i) be approved by a majority of the members of the Board of Directors and by a majority of the disinterested members of the Board of Directors and (ii) be on terms no less favorable to us than could be obtained from unaffiliated third parties.

PART IV

Item 15. Exhibits, Financial Statement Schedules

(a) Financial Statements and Schedule. (Previously filed with the Original Annual Report.)

(b) Exhibits.

31.1 Certificate of Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities and Exchange Act of 1934, as amended.

31.2 Certificate of Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities and Exchange Act of 1934, as amended.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

TARRANT APPAREL GROUP

By: /S/ GERARD GUEZ

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Gerard Guez
Interim Chief Executive Officer

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

SIGNATURE	TITLE	DATE
/S/ GERARD GUEZ Gerard Guez	Chairman of the Board of Directors and Interim Chief Executive Officer (Principal Executive Officer)	January 14, 2008
/S/ PATRICK CHOW Patrick Chow	Chief Financial Officer (Principal Financial and Accounting Officer) and Director	January 14, 2008
* Todd Kay	Vice Chairman of the Board of Directors	January 14, 2008
* Milton Koffman	Director	January 14, 2008
* Stephane Farouze	Director	January 14, 2008
* Mitchell Simbal	Director	January 14, 2008
* Joseph Mizrachi	Director	January 14, 2008

SIGNATURE	TITLE	DATE
* Simon Mani	Director	January 14, 2008

* By: /S/ Gerard Guez
Gerard Guez, Attorney-in-fact

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