

ABAZIAS, INC.

(OTC BB:ABZS)

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Recent Price: \$0.0800  
Target Price: \$0.3000  
(12 month)

SPECULATIVE BUY RATING

Main Headquarters

Abazias Diamonds  
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A Leader in Online Diamond & High End Jewelry Retail  
*Company Overview*

Abazias Inc. (OTC BB:ABZS) was founded in October 2001 in Gainesville, FL and is an online retailer of loose diamonds and fine jewelry featuring diamond settings. Major and minor US laboratories (e.g. GIA, EGL & AGS) independently have certified most of the diamonds in their inventory. The company manufactures more than 100 styles of fine jewelry including wedding bands, rings, necklaces, bracelets and earrings.

- Abazias is the first public company focusing on loose Diamonds sold direct to public over internet at discount prices of up to 50% on its site at [www.abazias.com](http://www.abazias.com). The company boasts with the largest online database with more than 84,000 diamonds and 93,000 carats available, valued in excess of \$400 million.
- Most of Abazias diamonds are independently certified. ABZS has created a strong customer following based on customer service and site innovations that let shoppers create their own jewelry. In addition to delivering quality diamonds at wholesale prices through favorable wholesale diamond supply relationships, Abazias is also a full-service jeweler offering a large selection of settings for stones purchased.
- According to Forrester Research, Jewelry e-commerce sales was expected to hit \$2.8 billion in 2005, up from \$2 billion in 2004. According to the company the total jewelry market is worth close to \$50 billion of which diamond jewelry accounts for about \$27.5 million and diamond engagement rings is worth about \$4.5 billion.
- Preliminary results announced showed FY2006 Q2 Revenue grew by 49% y-o-y to \$1.1 million with gross margin improvements to 21% and ABZS turning profitable with net income of \$66,726 compared to Q1 FY2006 net loss of \$49,608. Abazias is promoting the company through consumer public relations & an exclusive strategic marketing alliance with Paris Hilton Limited Edition Watches. ABZS sold a single diamond for \$86,000 the 2nd largest sale in the company's history during Q1 FY2006. Abazias CEO sees the penetration of the Internet as a channel for specialty retail sales (such as jewelry & watches) likely to accelerate as more customers move towards on-line shopping for price benefits and choice of tailoring etc.
- Its close relationships with diamonds suppliers are critical to its longer-term success and are a barrier to entry in the online diamond industry. Abazias enjoys relationships with 100 suppliers, 20 of which are primary and favorable credit arrangement benefits, typically allowing net 30 days to pay its suppliers.
- Early indications suggest the company is succeeding at its strategy of exceptional and high quality customer service. Currently the average sale of Abazias is roughly \$5,500, exceeding that of its larger rival Blue Nile at \$1,400 per transaction.
- Operating costs are low allowing the company to derive greater benefit at the bottom line if topline growth occurs, as a result of its high operating leverage.
- Abazias is cashflow positive, carries no debt on its balance sheet and is accelerating inventory turns. The company is currently making technological enhancements to its website and has established an enviable online industry search engine presence with name optimization that improves visibility. ABZS is broadening its strategy to replicate its success with online diamond retail with jewelry. FY2006 appears to be a breakout year for the company with first half revenues of over \$2.2 million already eclipsing revenues earned for the entire FY 2005. We have a favorable view of the strategic positioning of the company, the ability to execute and extract benefit from its highly scalable business model. Should current growth and sales trends persist or accelerate, we anticipate a waning of the valuation gap with its larger competitor Blue Nile (NASDAQ: NILE). Our 12-month target price is set at 30.0c, which is a blend between the forward price to sales approach (2.5x FY2007 Revenue estimate of \$9.36 million and our discounted PE methodology using our FY2006 and FY2007 EPS and revenue forecasts (SEE TABLE).

ABAZIAS DIAMONDS  
(all figures in Millions)

52 Week Hi/Lo Range	0.15/0.05
Fiscal Year End	31-Dec
Shares Outstanding (6/30/2006)	85.9
Float (approximately)	18.5
Share price (08/18/2006)	0.080
Market Capitalization	6.9
Average Volume (3 months)	0.127
Insider Ownership	65%
Institutional Ownership	0%
Enterprise Value (EV)	6.77
Long Term Debt (06-30-06)	0.000
Total Cash (06-30-06)	0.105

12/31/2006 12/31/2007

	FY2006 E	FY2007 E
Earnings Per Share (EPS)	0.003	0.011

Book Value (\$/share)	0.005	0.017
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	FY2006 E	FY2007 E
Total Revenue	5.200	9.360
Cost of Sales	4.108	7.020
Gross Profit/Loss	1.092	2.340
Operating expenditures	0.754	1.310
Income/Loss from Operations	0.338	1.030
Net Interest Expense	0.070	0.055
Tax Items	0.000	0.000
Net Income	0.268	0.975

NA = Not applicable/Not Available.  
A = Actual Reported figures E = Estimates

Balance Sheet & Financial Statement Extracts (6/30/2006)

Current Assets	0.574
Current Liabilities	0.405
Total Assets	0.605
Accumulated Deficit	3.733
Total Shareholders Equity	0.200

Capital Structure (as at 06-30-06)

Authorized Common Stock	150 000 000
Authorized Preferred Stock	1000 000

## COMPANY

Abazias (**OTC BB:ABZS**) specializes in direct sales of diamonds to the public on the Internet at discount prices. The company was founded in October 2001 and is headquartered Gainesville, Florida. The company became public in October 2003 under symbol ABZS and is listed on the OTC Bulletin Board.

Abazias, Inc. boasts a database of **over 80,000 certified diamonds**, provided at discounts of up to 50%. Abazias also incorporates its diamonds into **fine jewelry settings for earrings, bracelets, wedding bands, and engagement rings**. It has recently expanded its offerings to include **limited edition** and **ready-to-wear line of Paris Hilton watches** that allows the company to also reach the lucrative accessory shopper with this iconic brand that has international appeal. Other high-end brands such as **Seiko** and **Tag Heuer** are also available.

Originally incorporated in 1994 under the name Biologistics, the corporation went through a series of reverse mergers from 1997 to 2002 period in order to become an operating company. A reverse acquisition is one way for a company to become publicly traded, by acquiring a public company and then installing its own management team and renaming the acquired company. In October 2003 ABZS, then called **Skintek Labs Inc.**, acquired Abazias, Inc. and the corporate name was changed to Abazias, Inc. This name, while somewhat cumbersome to remember and spell, was originally chosen at a time when Internet search engines sorted results alphabetically. **Search engine optimization (SEO) is an important technique to attract customers** and to this day the company **has enjoyed a dominant search position** under many key search terms in Google and other search engines (such as "loose diamonds").

Abazias is proud to be recognized for having **superior customers service** and **no inventory bias** to taint the selling process. The company has a favorable cashflow position, as it requires its customers to pay for diamonds and jewelry prior to shipment, whilst **enjoying terms with suppliers of up to a net 30 days to settle its own shipments** from the suppliers. The **Return Rate** Since Inception has been **astonishingly low averaging around 1% of shipments** and has lodged consistent year-over-year Growth since Inception.

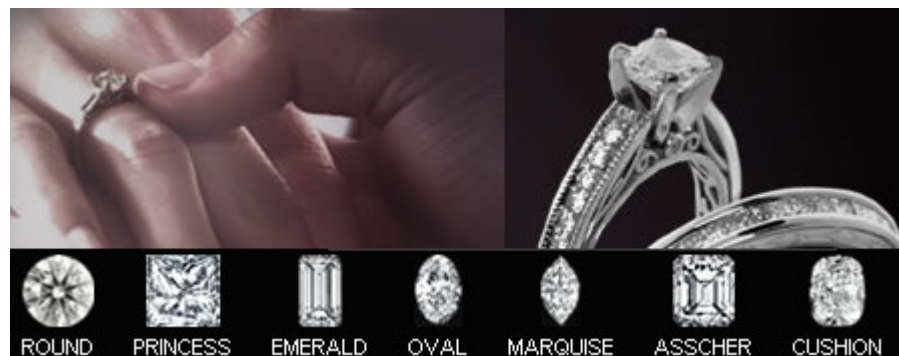
Abazias is the **Low Cost Leader of Loose Diamonds on Internet** (up to 50% less than offline retailer/25% online retailers) and boasts with the largest inventory available online. The company has **virtually no inventory holding costs and a highly scalable business model**. Fixed costs are similar to that of a small retail outlet, yet ABZS has the effectiveness of a Super Wal-Mart store. Abazias continually strives to enhance its visibility via search engine optimization and to enhance its website.

## PRODUCTS

Abazias provides a broad array of loose diamonds on its website: [www.abazias.com](http://www.abazias.com). With an offering of over 70,000 diamonds, Abazias has one of the largest databases available on the Internet. In addition to wholesale diamonds, Abazias creates a variety of fine jewelry settings for its stones, including earrings, bracelets, necklaces and rings.

Major and minor laboratories, including the **Gemological Institute of America (GIA)**, the **American Gem Society (AGS)**, and the **European Gemological Laboratories (EGL)**, has certified almost all of the diamond stones sold by ABZS. A diamond certificate, or grading report, contains characteristics of the diamond that make up its value. Grading laboratories like those cited will measure and grade diamonds sent to them by wholesalers and retailers and provide certificates. Certification is a crucial element to buying diamonds safely on-line. Producing high quality, fine jewelry is another important offering the company emphasizes. Abazias constructs a variety of tailor-made settings to ensure a full-service experience for the consumer. This product line offers wider margins and recurring revenues.

According to the company, the pricing of stones is formulaic. Each aspect of a diamond – cut, clarity, carat weight and color – commands a specific price point. Consequently, all competitors in the industry are affected equally when market prices rise and fall. It is the company's sound business model and supplier arrangements that make it possible to provide deep price discounts regardless of fluctuating diamond values.



*See Appendix A-I for Analyst Certification and Important Disclosures.*

## BUSINESS MODEL

The company has a business model with the following three key features:

### ❑ Unique Supply Chain

The Proprietary database is the largest for diamonds found online worth over \$350 million in wholesale value. Given this supply chain the company does not carry any inventory and is therefore able to eliminate mark-up layers that may be existent in other areas of the jewelry and/or diamond industry and this enables Abazias to share these savings with the customer.

### ❑ Scalable Model

The business model is such that ABZS can reach a \$50 million annual turnover with virtually the same resources as a single unit retailer with a \$5 million SG&A expense. With an operational efficiency of small retailer Abazias enjoys a unique business model with unit availability **akin to that of a MEGASTORE**.

### ❑ Online Advantage

The model allows ABZS to improve its Asset Efficiency by increasing the Return on Assets (ROA), the Return on Investment (ROI), Sales/Employee and Capital Efficiency, by lowering Capex and Capital Acquisition Costs.

## BUSINESS STRATEGY

Abazias was the brainchild of founder and CEO, Oscar Rodriguez. After **nearly twenty years in the diamond business and work in the jewelry industry**, Mr. Rodriguez enjoys strong relationships with diamond wholesalers and deep knowledge of the industry. **He viewed the Internet as a powerful additional channel, along with retail stores, through which high quality diamonds could be sold to the public.** In October 2001, Abazias was launched.

The three key characteristics to the company's business strategy are:

- **Exceptional Customer Service;**
- **Favorable Diamond Supplier Relationships; and**
- **Operating Leverage.**

### Exceptional Customer Service:

Unlike a female shopper, who may prefer a more tactile shopping experience, the Abazias customer usually is most interested in detailed specifications and whether the diamonds are genuine. The typical Abazias customer is male, 25-45 years old. These are Internet savvy, highly knowledgeable consumers who perform significant research on diamonds, and seek better selection at lower prices online. Virtually all stones are certified by the GIA, AGS and EGL. Abazias sales force is equipped to educate customers and build trust, thanks to an extensive and continuous in-house training program. **Customer service staff answers about 85% of all calls to the call center within 10 seconds.** Abazias also extends a 10 day unconditional return policy to all its customers, and offers a lifetime trade up of 80% of the price of the original diamond purchase.

Early indications suggest the company is succeeding at high quality customer service. **With an average sale of \$5,500, Abazias (ABZS) exceeds that of its larger competitor Blue Nile (NILE), at \$1,400.**

### Favorable Diamond Supplier Relationships:

Abazias enjoys relationships with 100 suppliers, 20 of which are primary. **Close relationships with diamond suppliers are a critical success factor and barrier to entry in this industry.** For diamond wholesalers, Abazias provides incremental revenue by selling their stones over the Internet, accelerating inventory turns. For Abazias, vast numbers of diamonds are available to customers, but the **company's capital is not tied up in holding physical inventory, producing strong operating leverage.** The arrangement is a win-win situation for both parties.

### Operating Leverage:

Abazias has no physical inventory to carry and no stores to maintain. Low capital costs and extensive diamond offerings give the company a highly scalable business model. Greater top line growth can consequently move faster to the bottom line because operating costs are low. As a result, Abazias has a **competitive advantage over jewelry stores**, which cannot achieve the wide margins at discount prices due to higher overhead. Also contributing to strong operating leverage are the credit arrangements Abazias has with suppliers.

*See Appendix A-I for Analyst Certification and Important Disclosures.*

In a typical transaction, each customer pays Abazias ahead of actual shipment of the diamond. The company, however, has net 30 days to pay its suppliers. Between 20 and 30 diamond and fine jewelry suppliers provide credit to ABZS in amounts ranging from zero to \$100,000.

Due to these arrangements, Abazias buys only those diamonds that are actually ordered and paid for by customers. If a customer returns an item, shipping and insurance costs are borne by the customer. The company will then refund the customer and ship the item back to the dealer. In most cases, the 30-day credit window is still open and no monetary exchange is needed; if not, the dealer will refund Abazias by bank wire transfer. These arrangements minimize working capital levels and benefit cash flow. One risk factor to the company's operations is if key relationships with diamond suppliers were somehow jeopardized or credit not extended. This risk is offset, however, by the diverse number of suppliers that work with Abazias.

## INDUSTRY & COMPETITION

The market opportunity, therefore, is immense. According to the Abazias, **the size of the total jewelry market approximates \$51 billion. Diamond jewelry accounts for about \$27.5 billion** of that total, and **diamond engagement rings, \$4.5 billion**. As investors are discovering, the market for diamonds has never been hotter.

Analysts are projecting that the **world's largest diamond merchant, De Beers' Diamond Trading Company**, will rack up \$6.6 billion in sales during 2006. In addition, news reports indicate that mining operations around the globe are gearing up for record production. In Venezuela, for example, President Hugo Chavez has formed the National Mining Corporation, which will take back underutilized mines and increase production in that country. At the same time, Australia and Canada are drawing investors for mineral exploration. In Africa, Namibia's stable government has paved the way for mining investments by offering mineral royalties, and is optimistic that the 28 % diamond production increase during 2004 will be repeated.



Picture:

**Paris Hilton, Lucien Lelong of Parlux and Oscar Rodriguez from Abazias.com**

Increases in diamond imports also bode well for investors in this industry. In China, for example, imports increased by 11 % in 2005. At the retail level, **LVMH Moet Hennessy Louis Vuitton saw a 16 % increase in sales of watches and jewelry in 2005**. The **typical luxury goods customer spends close to \$50,000 each year** on such goods, and the luxury market, as well as the diamond trading and mining industries are expected to continue their upward growth trend.

This industry is highly **competitive, very fragmented, and characterized by seasonality**. (The company's fourth quarter usually accounts for 25%-35% of annual sales which is mostly due to the year-end holiday shopping period.) The competitive landscape includes other on-line diamond and jewelry retailers, as well as jewelry and department stores, on-line auctions like eBay, catalogue and television shopping channels like QVC, discount retailers, and others.

**Blue Nile is the Abazias's most comparable and largest competitor**, with a similar on-line business model. Listed on the NASDAQ-NM and trading at a market value of \$532 million, Blue Nile currently enjoys greater capital resources and financial flexibility compared to Abazias.

Still, it is the small, independent jewelry shops that stand to lose the most from competitors like Abazias. **The Jewelers Board of Trade & IDEX estimates the number of independent jewelers has declined each year since 1996, a total drop of 12%**. The value/selection/price/convenience formula of an on-line jeweler is hard for small off-line shops to match.

According to the company, it is the low cost leader in the market, **providing up to 50% discounts** compared to offline retail competition **and 25% discounts compared to other on-line competitors**. On-line buying continues to gain momentum, particularly for high-ticket items. According to International Data Corp (IDC), worldwide business-to-consumer e-commerce spending will increase from \$295.4 billion in 2004 to \$1.1 Trillion by 2009. On-line buying increased 42% in 2003 compared to 2002.

According to Consumer Internet Barometer, **On-line sales for jewelry and watches were \$900 million in 2003, up 36%**. Standard & Poor's (S&P) notes that growth in on-line purchases is the result of compelling convenience, selection, information, and value compared to off-line competitors. Consumers can find what they want quickly, do thorough research, and find attractive prices.

**Moreover, most internet purchases don't require paying state and local taxes, which adds substantially to overall value.** Advances in technology have made e-commerce transactions easier to complete, with higher levels of security and reliability. Approximately 70% of U.S. households have Internet access, and broadband penetration is nearing 70% as well. The penetration of the Internet as a channel for specialty retail sales is likely to accelerate as more consumers move towards on-line shopping. The men's jewelry market is exploding, and this new market segment is increasing the demand for diamonds. Men's jewelry sales are up a reported 20%, and as a result, an increasing number of fine jewelry manufacturers are introducing or expanding their men's lines.

All of these trends bode well for the industry and Abazias.

## RECENT DEVELOPMENTS

Abazias recently launched a **newly redesigned website**. This initial version of the new site features a **more refined style and enhanced functionality**. The new site offers a variety of new features, designed with customers in mind. The launch of the beta site **introduces a personal shopper, the first in the industry**; a comprehensive and easy-to-use ring builder and the elaborate, enhanced diamond education section.

As a part of the successful redesign and launch of their website, **has doubled the amount of their privately branded Couples Diamond®**. The rare Couples Diamond®, with a Hearts & Arrows Ideal Cut offers the highest grades of polish and symmetry, allowing the diamond to reflect more light than the standard American Ideal cut.

The exclusive Couples Diamond® is the the ultimate, most significant cut diamond man can produce and accounts for less than 10% of all diamonds cut, according to Abazias CEO, Oscar Rodriguez. The company offers these diamonds as the ultimate expression of love and luxury, strategically increasing its access to these stones, due to their perfection, popularity and impeccable standards that are synonymous with Abazias.

On August 10, 2006 Abazias unveiled an **expanded selection of watches and non-engagement jewelry highlighted by the ready-to-wear watch line by Paris Hilton**, named simply "Paris Hilton." These Paris Hilton watches range from \$138 to \$230 per item and is available only at a select number of online dealers. Abazias maximized their existing relationship with the Paris Hilton brand to offer not only the Limited Edition watches that feature a retail price upwards of \$100,000 but also the "Paris Hilton" line, to attract a wider range of shoppers.

The limited edition line of wathes are truly unique and masterly crafted with four clove design. **Abazias has an exclusive right to market these limited edition items online**. The brilliance of 1,026 stones combined with the quality of the Swiss setting and movement makes each watch spectacular. Priced at between \$100,000 and \$250,000, the 4 timepieces – "Pink is Love," "Canary," "Cotton Candy," and "Snow White" – each feature over nine carats of diamonds ranging from natural intense pink diamonds to near colorless white diamonds.

The watch specifications are detailed below:

### Cotton Candy:

The Paris Hilton Limited Edition Cotton Candy Watch features a 50mm solid 18kt rose gold with approximately nine carats and 1026 stones of WS1 near colorless white diamonds. Genuine sapphire cabochons are set on the crowns while the main crown is set with diamonds. The six sapphire crystals are set on the gold pave dial. The Swiss made timepiece is designed with a hand made setting, one Swiss automatic movement, four Swiss automatic movement and finely appointed with a genuine black alligator strap. A turn of the bezel will reveal either five time zones or four cloves. Cotton Candy retails for \$100,000.

### Canary:

The Paris Hilton Limited Edition Canary Watch features a 50mm solid 18kt yellow gold with approximately 1026 stones, 6.07 carats of natural intense yellow diamonds and 3.03 carats of WS1 near colorless white diamonds. Genuine sapphire cabochons are set on the crowns while the main crown is set with diamonds. The six sapphire crystals are set on the gold pave dial. The Swiss made timepiece is designed with a hand made setting, one Swiss automatic movement, four Swiss automatic movement and finely appointed with a genuine yellow alligator strap. A turn of the bezel will reveal either five time zones or four cloves. Canary retails for \$150,000.

### Pink Is Love:

The Paris Hilton Limited Edition Watch features a 50mm solid 18kt rose gold with approximately nine carats and 1026 stones of WS1 near natural intense pink diamonds. Genuine sapphire cabochons are set on the crowns while the main crown is set with diamonds.

*See Appendix A-I for Analyst Certification and Important Disclosures.*

The 6 sapphire crystals are set on the gold pave dial. The Swiss made timepiece is designed with a hand made setting, one Swiss automatic movement, four Swiss automatic movement and finely appointed with a genuine pink alligator strap. A turn of the bezel will reveal either five time zones or four cloves. Pink is Love retails for \$200,000.

Abazias has identified the Paris Hilton brand as iconic with an international appeal. Abazias has strategically aligned themselves with a partner who is on the pulse of pop culture and can now effectively reach the lucrative 'accessory' shopper.

## THE PARIS HILTON LIMITED EDITION COLLECTION

### PINK IS LOVE



### CANARY



### SNOW WHITE



### COTTON CANDY



Abazias.com has created a strong customer following based on customer service and site innovations that let shoppers create their own jewelry. In addition to delivering quality diamonds at wholesale prices, Abazias.com is also a full-service jeweler offering a large selection of settings for stones purchased. In the coming 12 months the company intends on building shareholder value and increase sales by focusing and placing more emphasis on its specialty jewelry business that adds value and flexibility of individual tailoring preferences of the customer. **We anticipate a stronger emphasis over time on fine jewelry sales, should drive greater sales volumes and wider margins.**

Abazias Diamonds has a unique way of doing business which means the customer gets the best value on quality loose diamonds and discount diamond jewelry, without having to sacrifice personalized service. And with over 83,000 diamonds available to select from the customer is virtually guaranteed to find the perfect diamond for his/her budget or taste.

*See Appendix A-1 for Analyst Certification and Important Disclosures.*

## FINANCIAL STATEMENTS

Abazias is an early-stage company and financial data is limited. The company filed Form 10-QSB with comprehensive financial information and operational discussion with the SEC with regards to financial performance and developments for the second quarter of FY2006 on August 14, 2006. Figures for the most recent quarter (3 months to June 30, 2006) are un-audited. The company has a December 31 year-end.

During Q1 FY2006, the company posted sales of \$1.1 million, a 167% increase over the same period last year. A "guerrilla" marketing campaign and improved search engine optimization increased the on-line visibility for the company, generating higher sales volumes. The operating loss position widened 87% to \$(47,883) from an operating loss in the first quarter of 2005 of \$(25,645). This was the result of important investments made in the business during the quarter, which included hiring sales staff, boosting on-line marketing campaigns to enhance ABZS search engine rankings, and finally a website upgrade. The net loss consequently widened to \$(49,608) or 0c EPS from a net loss of \$(27,370) or 0c EPS in the same period of 2005.

Sales for Q2 FY2006 (3 months ended June 30, 2006) **rose 46% to \$1.076 million from \$735,683 in Q2 FY2005**, primarily due to an increase in online marketing campaigns, especially with respect to increasing visibility on search engine rankings. This was as a result of the extensive internal search engine optimization campaign and also increased expenditure and corresponding exposure in certain jewelry and general retail Internet portals, like pricegrabber.com and pricescope.com.

Cost of sales for Q2 FY2006 increased 51% to \$934,499 from \$618,258 in Q2 FY2005 due to the corresponding increase in the amount of diamonds and jewelry sold for the period. This corresponding increase in costs was consistent with the proportional increase in additional sales for the period. SG&A expenses for the three months ended June 30, 2006 remained flat (\$142,133 vs. \$141,633) over same period in FY2005, despite higher revenues. Accordingly, the net loss for the three months ended June 30, 2006 vs. three months ended June 30, 2005 decreased 94% to \$1,517 from \$25,933. We believe the highly scalable model of Abazias offers the prospect of reaching profitability and becoming cash flow positive in the near-term, assuming sales volume continues to accelerate. We expect profitability on net income basis for the full year of FY2006.

Abazias has total stockholders equity of \$200,329 as of June 30, 2006 and positive working capital of \$168,558. This represents a slight decline over December 2005, when stockholders equity was \$239,534 and working capital was \$236,174. Like most of early stage companies, Abazias has incurred losses since its inception. The Issuance of shares has funded operations. Because it is not a capital-intensive business, we believe Abazias can eliminate its accumulated deficit fairly quickly.

We consider the solid balance sheet, characterized by no long-term debt, as an offset to temporary cash flow problems. Although not guaranteed, a strong balance sheet typically provides a company with the flexibility to raise funds as needed.

### Liquidity and Capital Resources

In October 2005, Abazias announced the completion of the first tranche of an anticipated two tranche private placement with Famalom, LLC, in the amount of \$500,000. This private placement helped shore up the company's weak capital base. An additional capital infusion, funded either through a debt or a stock offering, is anticipated during fourth quarter 2006. During the three months ended June 30, 2006, Abazias issued no stock.

The company generated **negative cash flow from operations** in the first half of FY 2006, of \$150,477 compared to positive cashflow of \$43,471 during same period a year ago. This can be ascribed predominantly to a large drop in Accounts Payable balances in year ago period. A wider net loss accompanied by higher receivables and inventory to fulfill sales was also behind the result.

Although this cash flow position is currently negative, management feels reasonably confident that it is in a position to maintain or increase the required level of sales, and/or reduce corresponding expenses as needed to fulfill its financial obligations from a cash flow perspective on an ongoing basis into the future, although there is no assurance ABZS can do so. In addition the majority stockholder, Oscar Rodriguez advances money to Abazias on an as-needed basis.

The advances are due on demand, bear no interest and have no collateral. **At June 30, 2006, the amount of the advance was \$68,235** and the majority stockholder has not needed to make an advance on behalf of the company for the last 8 quarters.

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**Other noteworthy financial and per share statistics are listed in the table found on page 1 of this report.**

## RISK FACTORS / CONCERNS

ABZS is a company that has **is in development stage company status**. The company is still considered to be early in its life cycle and has limited meaningful reported revenues or financial history. The business model, and longer-term consistency of revenue and income potential, remain uncertain and is not fully proven. As a result, it is difficult to accurately forecast net sales and for ABZS to plan operating expenses. ABZS bases its current and future expense levels on operating forecasts and estimates of future net sales. Net sales and operating results are difficult to forecast because they generally depend on the volume and timing of the orders received, which are uncertain. Some of its expenses are fixed, and, as a result, ABZS may be unable to adjust its spending in a timely manner to compensate for any unexpected shortfall in net sales.

ABZS inability to maintain and expand its diamond and fine jewelry supply relationships on commercially reasonable terms or the inability of its current and future suppliers to maintain arrangements for the supply of products sold to ABZS on commercially reasonable terms would substantially harm its business and results of operations. Suppliers and manufacturers of diamonds as well as retailers of diamonds and diamond jewelry are vertically integrated and we expect they will continue to vertically integrate their operations either by developing retail channels for the products they manufacture or acquiring sources of supply, including, without limitation, diamond-mining operations for the products that they sell. To the extent such vertical integration efforts are successful, some of the fragmentation in the existing diamond supply chain could be eliminated and its ability to obtain an adequate supply of diamonds and fine jewelry from multiple sources could be limited and its competitors may be able to obtain diamonds at lower prices.

Demand for ABZS products has been highly sensitive to pricing changes in the past. Changes in its pricing strategies have had and may continue to have a significant impact on its net sales, gross margins and net income. The online market for diamonds and fine jewelry is significantly less developed than the online market for books, music, toys and other consumer products. If this market does not gain widespread acceptance, its business may suffer. Its success will depend, in part, on its ability to attract consumers who have historically purchased diamonds and fine jewelry through traditional retailers. Purchasers of diamonds and fine jewelry may not choose to shop online, which would prevent Abazias from increasing net sales.

The company may not be able to generate or obtain sufficient funds to operate its business plan and fund future expansion initiatives. The company may not succeed in continuing to establish the Abazias brand, which would prevent it from acquiring customers and increasing its net sales. **In order to increase net sales and to sustain or increase profitability, ABZS must attract customers in a cost-effective manner.** The company's business may suffer if it fails to maintain favorable supply relationships with its wholesale diamond suppliers or if its credit terms are changed that will hurt its operating leverage and cashflow position. If the company's ability to honor or perform shipments are interrupted for any significant period of time for any reason, its business and results of operations would be substantially harmed. The company faces the risk of theft of products from inventory or during shipment.

ABZS faces significant competition and may be unsuccessful in competing against current and future competitors. The retail jewelry industry is intensely competitive, and the company expects competition in the sale of diamonds and fine jewelry to increase and intensify in the future. Increased competition may result in price pressure, reduced gross margins and loss of market share, any of which could substantially harm its business and results of operations. Current and potential competitors include: independent jewelry stores; retail jewelry store chains, such as Tiffany & Co. and Bailey Banks & Biddle; other online retailers that sell jewelry, such as Amazon.com and Blue Nile; department stores, chain stores and mass retailers, such as Nordstrom and Neiman Marcus; online auction sites, such as eBay; catalog and television shopping retailers, such as Home Shopping Network and QVC; and discount superstores and wholesale clubs, such as Costco Wholesale and Wal-Mart. In addition to these competitors, we may face competition from suppliers of its products that decide to sell directly to consumers, either through physical retail outlets or through an online store. Many of its current and potential competitors have advantages over Abazias, including longer operating histories, greater brand recognition, existing customer and supplier relationships, and significantly greater financial, marketing and other resources. In addition, traditional store-based retailers offer consumers the ability to physically handle and examine products in a manner that is not possible over the Internet as well as a more convenient means of returning and exchanging purchased products.

The company makes allowances for product returns in its financial statements based on historical return rates. Actual merchandise returns are difficult to predict and may differ from these allowances. Any significant increase in merchandise returns above such allowances would substantially harm the business and results of operations. The satisfactory performance, reliability and availability of Abazias website, transaction processing systems and network infrastructure are critical to ABZS reputation and its ability to attract and retain customers and to maintain adequate customer service levels.

Any failure to rapidly respond to technological change could result in services or systems becoming obsolete and substantially harm business and results of operations. Any failure to address risks associated with payment methods, credit card fraud and other consumer fraud could damage its reputation and brand and may cause business and results of operations to suffer.

Luxury products, such as diamonds and fine jewelry, are discretionary purchases for consumers. The volume and dollar value of such purchases may significantly decrease during economic downturns. Future net sales and profits are substantially dependent upon the continued growth in the use of the Internet as an effective medium of business and communication by its target customers. Internet use may not continue to develop at historical rates and consumers may not continue to use the Internet and other online services as a medium for commerce.

The company is **not currently subject to direct federal, state or local regulation other than regulations applicable to businesses generally or directly applicable to retailing and online commerce**. However, as the Internet becomes increasingly popular, it is possible that laws and regulations may be adopted with respect to the Internet, which may impede the growth of the Internet or other online services. These regulations and laws may cover issues such as taxation, advertising, intellectual property rights, freedom of expression, pricing, restrictions on imports and exports, customs, tariffs, information security, privacy, data protection, content, distribution, electronic contracts and other communications, the provision of online payment services, broadband residential Internet access and the characteristics and quality of products and services. Further, the growth of online commerce may prompt calls for more stringent consumer protection laws.

Several states have proposed legislation to limit the uses of personal user information gathered online or require online companies to establish privacy policies. The Federal Trade Commission has also initiated action against at least one online company regarding the manner in which personal information is collected from users and provided to third parties. The adoption of additional privacy or consumer protection laws could create uncertainty in Internet usage and reduce the demand for Abazias products and services.

If the company is unable to generate or obtain sufficient funds to operate its business, it could harm results and force the company to curtail or cease planned operations. There can be no assurance the company will be successful in its effort to secure additional financing to support operations that will necessitate achievement of near and medium term goals. The majority stockholder, Oscar Rodriguez has advanced money to Abazias on an as-needed basis. Notwithstanding his willingness to make advances in the past, he is under no legal obligation to make further advances in the future.

Abazias Inc. is substantially dependent on the expertise of its management team and directors, the loss of which could materially adversely affect future anticipated results and efficiency of its expansion plans. Trading in the shares will continue to be subject to major fluctuations for the foreseeable future. The stock is thinly traded at prices below \$1.00 and selling of small positions could have a negative impact on the share price in absence of sufficient liquidity.

**We caution that historical volume activity on ABZS has been noticeably light, and we are unable to forecast future volumes with any degree of certainty.** Major dilution of common stock can occur if company issues large blocks of common stock are issued or warrants/options are converted into common stock that can negatively impact on the value of the shares either theoretically or if sold in the open market. NASD and SEC Regulations covering rules on Penny Stocks apply for ABZS. ABZS may need to implement additional finance and accounting systems, procedures and controls as they grow the business and organization and to satisfy new reporting requirements that could result in increased regulatory and other costs which could harm the profitability outlook.

Further elaboration on these above-mentioned and other risk factors can be found in **Form 10-QSB filed with the SEC on May 14, 2006.**

## MANAGEMENT & BOARD OF DIRECTORS

### Oscar Rodriguez – CEO & Director

Founder of Abazias, Mr. Rodriguez began his career in the jewelry industry in 1987, developing his expertise in gemology at Gause & Sons, one of the largest jewelry firms in the Gainesville, Florida metropolitan area. He received a certification in Diamonds and Diamond Grading from the Gemological Institute of America in 1990. In 1997, Mr. Rodriguez started his own retail store, OR Jewelry, which he still owns and operates. In October 2001, he launched the on-line business, Abazias, Inc.

### Jesus Diaz – CFO, Secretary & Director

Mr. Diaz joined the Company in June 2002. He assists in all aspects of the firm's operations, with an emphasis on systems management and finance administration. A graduate of the University of Florida, Mr. Diaz is an expert in internet marketing systems, having held the position of Chief of Operations at National WLD Techmark, Inc., an internet administration and marketing firm.

*See Appendix A-1 for Analyst Certification and Important Disclosures.*

**Aaron Taravella – Chief Information Officer (CIO) & Director**

Mr. Taravella is a software and database specialist responsible for implementing cutting-edge technology for Abazias. His primary focus is to implement software and hardware solutions that maximize productivity for the Company's proprietary systems. The overall reliability of the Company's website, including ease of use, is Mr. Taravella's responsibility. Since the age of 15, Mr. Taravella has written computer programs, later designing and writing software for various finance companies. With the development of the Internet, he gained experience in HTML and Perl, and created web-enabled backend administrative software for various e-commerce sites. Officers and directors beneficially own approximately 65% of the Company's outstanding common stock. Consequently, liquidity in this stock is very limited and price volatility is high. Only investors who can tolerate risk and shoulder loss should buy shares.

**INVESTMENT THESIS AND RECOMMENDATION**

Our analysis suggests that Abazias Inc. is an interesting speculative play among micro-cap companies offering exposure to the investor on a slice of the large specialty online jewelry market and unique competitive pricing position of the company in the online diamond market. The investor enjoys the benefit of being able to partake in an opportunity to invest in a company that is accelerating revenue, improving online visibility, and enjoying an expanding clientele through exciting jewelry offerings.

The online jewelry market was estimated to be worth \$51 billion in 2002. ABZS has a specific focus on the \$4.5 billion engagement ring market. The reader will appreciate the tremendous potential that exists for this company. A 1% market share would equate to \$50 million in annual sales, which is certainly conceivable when contracted to its closest competitor Blue Nile that generates around \$250 million annually. In the coming year, ABZS will focus more on increasing sales by focusing and placing more emphasis on its specialty jewelry business that adds value and flexibility of individual tailoring preferences of the customer. We anticipate a stronger emphasis over time on fine jewelry sales, should drive greater sales volumes and wider margins.

Both operating and financial risk involved in investing in young specialty jewelry companies are typically high and should be considered by investors. In this case the risks are tied mainly to the success of its marketing campaign, overall ability to penetrate the market and compete, raising its online visibility and also prospects of changing consumer spending patterns especially for luxury goods and high-end items, which may be negatively affected by a slowing economy. SG&A, raw material costs, development, marketing and other costs need to be managed well in order to achieve consistent profitability and stabilize margins, which has not occurred to date. Readers should understand that there can be no assurance that the company will be able to fast-track its intended path towards clinching a meaningful slice of the online jewelry market and ramp the pace of revenue growth experience in future quarters, that will flow through directly to the top and or bottom line to build a consistent longer term profitable track record to enrich shareholder value.

The decision to start out as a publicly traded company has both benefits and drawbacks. In the short-run, it will be challenging, expensive and time-consuming for this early stage company to comply with SEC reporting requirements. In the long-run, the financial transparency and discipline that comes from being public will benefit both shareholders and customers. With trust being such a critical success factor in the diamond business, going public at the outset sends a signal of management's willingness to accept public financial scrutiny and build Abazias for the long-run.

We therefore only recommend investors that have a high tolerance for risk that are able and willing to forfeit either most or all of their capital in search for extraordinary returns, to consider investing in the shares. Also, in our view investors willing to commit capital to ABZS should do so with absolute minimum 2 year investment horizon, but preferably longer, to allow ample opportunity for growth to emerge until broader price discovery can materialize within the investment community that will allow the value behind the new enhanced website and online offerings such as Paris Hilton line of watches, to be unlocked as new consumer awareness come to the fore and the company raises visibility and build brand recognition in its sector. Short term we expect that the price of ABZS is close to retesting historic highs and is likely to succeed at breaking out to challenge new ground from a technical point of view. We believe that the company will be able to manage its organic growth and deliver an improving financial and operational performance in FY2006/2007, that will ultimately lead to spurring investor confidence, appreciation and aid share price performance.

Based on recent Q2 results, improved margins and a seasonally strong second half of 2006 that lie ahead, coupled with the size of the market, it is our view that ABZS can post revenues of over \$5 million during FY2006. We remain uncertain about the extent of improvement in the operating cost structure in FY2006 that is achievable, but are confident that the company will manage costs well where they are able to control expenses.

For FY 2007 we believe that the company will achieve further top-line growth coming through as a result of FY2006 marketing and website improvement efforts and alliances with well known names with the luxury goods and accessory shopper such as the Paris Hilton brand. For valuation purposes and a guide to investors we are setting a 12-month target price of \$0.30 per share for ABZS.

We have used a revenue forecast of \$9.3 million, and net income figure of \$0.975 million for FY2007, which we believe is attainable. Readers should appreciate however that there is a large degree of forecasting risks associated with our projections.

Under the assumption that any further capital raising activity is well-managed to contain any further major I/O (issued and outstanding stock) increases and operating cash flow improve in FY 2007 as more progress is made to streamline and manage all the operations efficiently to meet customer demand, and no cancellations or terminations of existing supply relationships occur we are of the opinion that ABZS stock has compelling upside potential.

Our view is that the shares are currently under priced on a peer comparison perspective, and is not fully reflecting the expected positive financial improvements we expect in late FY 2006 and FY 2007. Given the current rate of growth in top line revenue in the most recent quarter and above average growth expected in next 2 years, we argue that should the company be able to move closer to the valuation parameters of its closest listed peer company Blue Nile (NILE). We are of the opinion that investors who can stay the course should enjoy market beating returns that far outstrip what the broad market can deliver whilst assuming more risk also, unless the company misses our expectations for future revenues and earnings by a meaningful margin.

In our opinion the future PE, the Price to Book multiples and Price to Sales multiples for ABZS should be at least in line with the sector average when looking 2 years ahead and discounting at an appropriate interest rate for the time value of money. We believe that the rating of the shares will be receive a boost as the company builds a longer track record and investor recognition improves.

TABLE

		Forward PE multiple	EPS Growth	PEG Multiple	Forward Price	Discount Rate (k)	Present Value
FY 2006 EPS	0.003	35.0	NA		0.11	5.2%	0.107
FY 2007 EPS	0.011	35.0	264%	0.16	0.40	5.2%	0.372
Average							0.239

Price to Book	14.68	Assumptions	Beta	2.10
Price to Sales	1.32		R <sub>f</sub>	4.8%
Current PE	NA		R <sub>m</sub>	5.0%
Forward PE	7.1		k	5.2%
(FY 2007 EPS)			$k = R_f + (R_m - R_f) * \text{Beta}$	
EV	6.77		FY2006 Net Income Forecast (\$m)	0.27
Debt/Equity	NA		FY2007 Net Income Forecast (\$m)	0.97
Current Ratio	1.417			

Using our FY 2007 revenue forecast of \$9.3 million and net earnings number of \$0.97 million (or 1.1c FY2007 EPS) and applying a forward PE multiple of 35x in line which is slightly less demanding than the current forward PE of NILE at 38.9x (FY2007 EPS of 90c for NILE on stock price of \$35), and doing the same for FY2006 numbers, we arrive at forward prices of 10.7c for 2006 and 37.2c for 2007. The PE ratio chosen is based on that of its closest peer and as a function of the expected growth rate and risk of a smaller emerging company. Incorporating for the above par growth (especially on top and bottom line income statement metrics that ABZS can post relative to Blue Nile and factoring in some PE contraction as a result of a possible US economic slowdown in 2007, we selected a PE of 35. We applied a discount rate (k) of 5.2%, which is a function of the stocks beta measure, risk-free rate as calculated in the Table above (SEE PAGE 11 - TABLE).

*See Appendix A-I for Analyst Certification and Important Disclosures.*

{k=Risk-free rate + (Market risk premium) \* Beta}

When using this discount rate and obtaining a present value estimate of market capitalization for ABZS of \$68 million or \$0.24 per share (average of 2006 and 2007 numbers), using a shares outstanding amount of 85.9 million. Using a price to sales methodology and applying a forward Price-to-sales metric of 2.5x (in line with that of NILE) our FY2007 revenue estimate of \$9.36 million we arrive at a stock price value of almost 30c. Given all these calculations and our bottom up analysis; which is more qualitative in nature, we set a 12-month target price for the security of \$0.30 per share.

All factors considered, we anticipate a stake in ABZS clearly has compelling upside potential in the coming 12 months and that is risk adjusted and absolute returns will far outpace that of the broad market as measured by the S&P 500 index as benchmark. We HIGHLIGHT to the reader that this forecast is made under the assumption that the company can attain our FY2006 revenue expectation of \$5.2 million and a minimum of 0.3c positive EPS and to extend that growth and profitability and earn 1.1c EPS in FY2007. Moreover, we believe that the present market for ABZS shares is far from efficient, does not fully reflect the leverage possible from recent developments such as its website enhancements, nor does it take into account the additional value for future business stemming from further penetration into the online jewelry market with novel approaches and niche offerings.

To summarize, we view the share price and corresponding market capitalization as modest. The dynamics of the OTC-BB is unlikely to consistently support true valuations based on financial performance and in many cases share prices respond 'after the fact' rather than 'ahead of the fact'. Hence, successful companies listed on the OTC-BB often handsomely reward investors if they are able to deliver and exceed expectations. Related companies in the industry are supporting much better share price performance on national exchanges.

Abazias Inc. already has a key market presence in defendable niche a lean operation from a fiscal perspective and has notched up consistent sales growth in recent quarters. We believe there exists huge room for growth and the company has the ability to ultimately dominate its own niche in the online jewelry segment. After reporting preliminary revenue of \$1.07 million during Q2 FY2006, we believe company is on track to generate \$5-5.5 million in revenue for FY2006 as a whole and post a small after tax profit (assuming zero taxes from tax credits that can be utilized). The challenge is for the company to capitalize on its breakout year in revenues, and also control the operating cost structure in an effort to turn a considerable profit (as measured as percentage of sales) in FY 2007 or sooner that will bolster the fundamental valuation of Abazias Inc.

The company has actually eliminated most long-term debt and increased sales at the same time over recent months. First quarter growth has extended into the second quarter and the rate of growth can increase as Q3 commences with a firm undertone. With the management team expressing their confidence in the future of this company by owning a large stake of ABZS, shareholders should expect the company to deliver growth as far as possible and that the company will be managed in a prudent manner.

Given these factors and under these aforementioned revenue, margin and profit assumptions, we initiate coverage on ABZS with a SPECULATIVE BUY rating. The rating assumes that the covered company will deliver returns that outperform that of the broad market (as measured by the S&P 500 index) by 25% or more over the next 12 months.

*Risk to our recommendation include amongst other: demand for its products, sharp escalation in the costs to acquire diamonds and precious metals, the company's ability to attract visitors to its website and convert those visitors into customers. Any lack of ability to retain existing customers or failure to encourage repeat purchases, inability to manage the product mix and inventory, major fluctuations in wholesale diamond prices, changing consumer tastes and preferences for diamonds and fine jewelry and/or major share dilution that can occur, if large quantities of shares are issued to raise capital or which is issued to pay for services, are some additional factors that will counteract price appreciation potential or cause shares to decline in value.*

*Any failure to successfully manage operations, excessive advertising and marketing costs, pricing wars and aggressive pricing and marketing strategies from competitors, unfavorable conditions in the internet and online e-commerce industry, high costs of enhancing and/or expanding its technology or website and lack of further penetration of the online jewelry markets can hamper share price performance. As a result, any cancellation, reduction or delay in agreements with diamond suppliers may materially adversely affect the business, financial condition and results of operations of Abazias. Additional risk factors that could adversely affect the attainment of our share price target include: general economic conditions and a variety of factors that is outside the control of the company, such as access to quality diamonds at commercially reasonable prices. Reduced capital spending budgets by ABZS's customers caused by an unanticipated industry downturn or a major contraction in the nationwide e-commerce and jewelry industries in general, albeit unlikely can lead to weak sales, which can result in decreased revenues, earnings levels or growth rates.*

*We would caution that given the size of the company (microcap) and risks involved, overall we advise private client positions be limited below 5% of the client's total portfolio size.*

*See Appendix A-1 for Analyst Certification and Important Disclosures.*

Charts For Abazias Inc.

ABZS

Last: 0.08

Last Trade: 8/18/06



## ANALYST CERTIFICATIONS

## APPENDIX A-1

The research analyst, who upon request wrote this report, certifies that the views expressed in this research report, accurately reflects his personal view about the subject company. The analyst also certifies that he does not own or have any beneficial interest in shares of the covered company, also that no part of his compensation was, is or will be directly or indirectly related to the specific recommendation or view expressed in this report. Tri-State Capital received \$7,000 in compensation for work on the subject company from a third party.

Based on the facts that were provided, the industry trends present and sources of information used to produce this report, it is my best opinion and reflection of what the company's rating and share appreciation potential could be once research coverage is widely adopted. Investors are urged to consider this report as only a single factor in making their investment decision. Information, opinions or recommendations contained in this report or research note are submitted solely for advisory and information purposes and we also do not accept any obligation to provide updates to this report in future.

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