

AMERICAN APPAREL, INC  
Form 10-K  
March 31, 2010  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**

(Mark One)

**Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
For the fiscal year ended December 31, 2009

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 001-32697

**American Apparel, Inc.**

(Exact name of registrant as specified in its charter)

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**Delaware**  
(State of Incorporation)

**20-3200601**  
(I.R.S. Employer Identification No.)

**747 Warehouse Street**

**Los Angeles, California 90021-1106**

(Address of principal executive offices) (Zip code)

**Registrant's telephone number, including area code: (213) 488-0226**

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

**Common Stock, par value \$.0001 per share**  
(Title of Each Class)

**NYSE Amex**  
(Name of Each Exchange on Which Registered)

**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

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

Indicate by check mark whether 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  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes  No

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant as of June 30, 2009 was approximately \$258,562,875 based upon the closing price of the common stock on such date as reported by the NYSE Amex.

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The number of shares of the registrant's common stock outstanding as of March 19, 2010 was 71,338,750.

### **DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the proxy statement for the registrant's 2010 Annual Meeting of Stockholders (the 2010 Proxy Statement), to be filed within 120 days of the end of the fiscal year ended December 31, 2009, are incorporated by reference into Part III herein. If the 2010 Proxy Statement is not filed in the 120-day period, the Items comprising the Part III information will be filed as an amendment to this Form 10-K not later than the end of the 120-day period. Except with respect to the information specifically incorporated by reference in Part III of this Form 10-K, the 2010 Proxy Statement is not deemed to be filed as part of this Form 10-K.

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**SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS**

This Annual Report on Form 10-K, including the documents incorporated by reference herein, contains forward-looking statements within the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. All statements in this Annual Report on Form 10-K other than statements of historical fact are forward-looking statements for purposes of these provisions. Statements that include the use of terminology such as may, will, expects, believes, plans, estimates, potential, or continue, or the negative thereof or other and similar expressions are forward-looking statements. In addition, in some cases, you can identify forward-looking statements by words or phrases such as trend, potential, opportunity, believe, comfortable, expect, anticipate, current, intention, estimate, position, assume, outlook, maintain, sustain, seek, achieve, and similar expressions.

Any statements that refer to projections of our future financial performance, our anticipated growth and trends in our business, our goals, strategies, focuses and plans, and other characterizations of future events or circumstances, including statements expressing general expectations or beliefs, whether positive or negative, about future operating results or the development of our products, and any statement of assumptions underlying any of the foregoing are forward-looking statements. Forward-looking statements in this report may include, without limitation, statements about:

future financial condition and operating results;

our ability to remain in compliance with financial covenants under our financing arrangements;

our plan to make continued investments in advertising and marketing;

our growth, expansion and acquisition prospects and strategies, the success of such strategies, and the benefits we believe can be derived from such strategies;

the outcome of litigation matters;

our intellectual property rights and those of others, including actual or potential competitors;

our personnel, consultants, and collaborators;

operations outside the United States;

economic and political conditions;

overall industry and market performance;

the impact of accounting pronouncements;

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management's goals and plans for future operations; and

other assumptions described in this Annual Report on Form 10-K underlying or relating to any forward-looking statements.

The forward-looking statements in this report speak only as of the date of this report and caution should be taken not to place undue reliance on any such forward-looking statements, which are qualified in their entirety by this cautionary statement. Forward-looking statements are subject to numerous assumptions, events, risks, uncertainties and other factors, including those that may be outside of our control and that change over time. As a result, actual results and/or the timing of events could differ materially from those expressed in or implied by the forward-looking statements and future results could differ materially from historical performance. Such assumptions, events, risks, uncertainties and other factors include, among others, those described under Item 1A and elsewhere in this report, as well as in other reports and documents we file with the United States Securities and Exchange Commission (the "SEC") and include, without limitation, the following:

changes in the level of consumer spending or preferences or demand for our products;

disruptions in the global financial markets;

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consequences of our significant indebtedness, including our ability to comply with our debt agreements and generate cash flow to service our debt;

the highly competitive and evolving nature of our business in the U.S. and internationally;

our ability to manage our growth and expansion both in the U.S. and internationally;

retailer consolidation and intensity of competition, both domestic and foreign, from other apparel providers;

technological changes in manufacturing, wholesaling, or retailing;

risks that our suppliers and distributors may not timely produce or deliver our products;

loss or reduction in sales to our wholesale or retail customers or financial nonperformance by our wholesale customers;

the adoption of new accounting pronouncements or changes in interpretations of accounting principles;

changes in consumer spending patterns and overall levels of consumer spending;

the availability of store locations at appropriate terms and our ability to identify and negotiate new store locations effectively and to open new stores and expand internationally;

ability to attract customers to our stores;

seasonality and fluctuations in comparable store sales and margins;

our ability to successfully implement its strategic, operating and personnel initiatives;

our ability to maintain the value and image of our brand and protect our intellectual property rights;

changes in the cost of materials and labor;

location of our facilities in the same geographic area;

our relationships with our lenders and our ability to comply with the terms of our existing debt facilities;

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adverse changes in our credit ratings and any related impact on financing costs and structure;

risks associated with our foreign operations and foreign supply sources, such as disruption of markets, changes in import and export laws, currency restrictions and currency exchange rate fluctuations;

continued compliance with U.S. and foreign government regulations, legislation and regulatory environments, including environmental, immigration, labor and occupational health and safety laws and regulations;

the risk that information technology systems changes may disrupt our supply chain or operations;

our ability to upgrade our information technology infrastructure and other risks associated with the systems that operate our online retail operations;

litigation and other inquiries and investigations, including the risk that we or our officers will not be successful in defending any proceedings, lawsuits, disputes, claims or audits;

ability to effectively manage inventory and inventory reserves;

changes in key personnel, our ability to hire and retain key personnel, and our relationship with our employees;

material weaknesses in internal controls;

costs as a result of operating as a public company; and

general economic conditions, including increases in interest rates, geopolitical events, other regulatory changes and inflation or deflation.

All forward-looking statements included in this document are made as of the date hereof, based on information available to us as of the date hereof, and we assume no obligation to update any forward-looking statement.

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**American Apparel, Inc.**

**ANNUAL REPORT ON FORM 10-K**

**FOR THE YEAR ENDED DECEMBER 31, 2009**

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**PART I**

**Item 1. Business**

Unless the context indicates otherwise, when we refer to ( we , us , our , or the Company ) in this Form 10-K, we are referring to American Apparel Inc. and its subsidiaries on a consolidated basis. Our year ends on December 31 and references to fiscal 2009, fiscal 2008 and fiscal 2007 refer to the years ended December 31, 2009, 2008 and 2007, respectively.

**Background of American Apparel, Inc.**

American Apparel, Inc., a Delaware corporation, was incorporated in Delaware on July 22, 2005 as Endeavor Acquisition Corp., a blank check company formed to acquire an operating business. On December 21, 2005, Endeavor Acquisition Corp. consummated its initial public offering, and on December 18, 2006, entered into an Agreement and Plan of Reorganization, amended November 7, 2007, with American Apparel Inc., a California corporation ( Old American Apparel ), and its affiliated companies. Endeavor Acquisition Corp. consummated the acquisition of Old American Apparel and its affiliated companies on December 12, 2007 (the Acquisition ) and changed its name to American Apparel, Inc. Pursuant to the Acquisition, Old American Apparel merged with and into AAI Acquisition LLC, a Delaware limited liability company and a wholly owned subsidiary of Endeavor Acquisition Corp. AAI Acquisition LLC survived the acquisition as a wholly owned subsidiary of our and changed its name to American Apparel (USA), LLC.

The Acquisition was accounted for as a reverse merger and recapitalization of Old American Apparel. Accordingly, for accounting and financial reporting purposes, Endeavor Acquisition Corp. was treated as the acquired company, and Old American Apparel was treated as the acquiring company. The historical financial information and the historical description of our business, for periods and dates prior to December 12, 2007, is that of Old American Apparel and its affiliated companies.

**Overview**

We are a vertically-integrated manufacturer, distributor, and retailer of branded fashion basic apparel. We design, manufacture and sell clothing for women, men, children and pets through retail, wholesale and online distribution channels. As of December 31, 2009, we operated 281 retail stores in 20 countries. Our wholesale business is a leading supplier of T-shirts and other casual wear to screen printers and distributors. We also operate an online retail e-commerce website at [www.americanapparel.com](http://www.americanapparel.com) where we sell our clothing directly to consumers.

We conduct our primary manufacturing operations out of an 800,000 square foot facility in the warehouse district of downtown Los Angeles, California. The facility houses our executive offices, as well as cutting, sewing, warehousing, and distribution operations. We conduct knitting operations in Los Angeles and Garden Grove, California, which produce a majority of the fabric we use in our products. We also operate dye houses that currently provide dyeing and finishing services for nearly all of the raw fabric used in production. We operate a dyeing and finishing facility in Hawthorne, California, which provides fabric dyeing and finishing services. We operate a garment dyeing and finishing facility, acquired in December 2007 and located in South Gate, California, which is used in cutting, sewing, dyeing and finishing garments. We operate a fabric dyeing and finishing facility, acquired in May 2008 and located in Garden Grove, California, which has been expanded to including knitting and cutting and sewing operations. Because we manufacture domestically and are vertically integrated, we believe this enables us to more quickly respond to customer demand and to changing fashion trends and to closely monitor product quality. Our products are noted for their quality and fit, and together with our distinctive branding these attributes have differentiated our products in the marketplace. American Apparel® is a registered trademark of American Apparel (USA), LLC.

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Old American Apparel was founded in 1998. Since inception, we have operated our wholesale business. In October 2003, we opened our first retail store in Los Angeles. In 2004, we began our online retail operations, and opened our first retail stores in Canada and Europe. Since 2005, we have opened stores in Asia, Australia, Israel, Latin America, and have further expanded throughout the U.S., Canada, Europe, and Asia.

### **Business Segments**

We report the following four operating segments: U.S. Wholesale, U.S. Retail, Canada, and International. We believe this method of segment reporting reflects both the way our business segments are managed and the way the performance of each segment is evaluated. The U.S. Wholesale segment consists of our wholesale operations and our online consumer operations in the U.S. The U.S. Retail segment consists of our retail store operations in the United States, which were comprised of 160 retail stores as of December 31, 2009. The Canada segment consists of our retail, wholesale and online consumer operations in Canada. As of December 31, 2009, the retail operations in the Canada segment were comprised of 40 retail stores. The International segment consists of our retail, wholesale and online consumer operations outside of the United States, and Canada. As of December 31, 2009, the retail operations in the International segment were comprised of 81 retail stores in the following 18 countries: the United Kingdom, Ireland, Austria, Belgium, France, Germany, Italy, the Netherlands, Spain, Sweden, Switzerland, Israel, Australia, Brazil, Mexico, Japan, South Korea, and China.

The results of the respective business segments exclude corporate expenses, which consist of the shared overhead costs of our Company. These costs are presented separately and generally include information technology, human resources, accounting and finance, executive compensation and legal. Financial information by segment, together with certain geographical information, for the fiscal years ended December 31, 2009, 2008 and 2007 is included in Note 20 to our consolidated financial statements under Part II, Item 8 Financial Statements and Supplementary Data.

### **Core Business Strengths**

American Apparel has relied on a number of core business strengths that it believes have contributed to its past success and will contribute to its future growth:

#### *Design Vision*

American Apparel's design, vision and aesthetic are intended to appeal to young, metropolitan adults by providing them with a core line of iconic, timeless styles offered year-round in a wide variety of colors at reasonable prices. Since its founding, American Apparel has operated with the belief that there is a large potential market among young adults for well-designed, high-quality fashion essentials. Led by Dov Charney, our Chairman of the Board of Directors, Chief Executive Officer and President, our in-house creative team has carefully developed the product line.

#### *Advertising and Branding*

American Apparel attracts customers through internally-developed, edgy, high-impact, visual advertising campaigns which use print, outdoor, in-store, and electronic communication vehicles. These advertising campaigns communicate a distinct brand image that differentiates us from our competitors and seek to establish a connection with our customers. Our retail stores are an important part of American Apparel's branding and convey a modern, internationalist lifestyle. At various times, we have also drawn attention to the "Made in USA" nature of our products and the "Sweatshop Free" environment in which our garments are produced.

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### *Speed to Market*

Our vertically integrated business model, with manufacturing and various other elements of our business processes centered in downtown Los Angeles, allows us to play a role in originating and defining new and innovative trends in fashion, while enabling us to quickly respond to market and customer demand for classic styles and new products. For our wholesale operations, being able to fulfill large orders with quick turn-around allows American Apparel to capture business. The ability to quickly respond to the market quickly means that our retail operations can deliver on-trend apparel in a timely manner, adhere to a policy of not discounting product at retail stores and maximize sales on popular styles by replenishing product that would have otherwise sold out.

### *Quality*

American Apparel prides itself on its use of quality fabrics. We have an active quality control department that oversees the in-house production of fabric at its knitting facilities. The quality control department also supervises outside knitting contractors who work to our strict specifications. The quality control department watches closely over the cutting, sewing, dyeing and finishing of our garments at our Los Angeles area facilities. Because cutting and sewing operations are conducted mostly in-house, we believe we have the ability to exercise greater control over clothing manufacturing than competitors who use contract sewing facilities.

### *Broad Appeal*

While initially targeted towards young, metropolitan adults in the U.S., the clean, simple styles and quality of our garments have helped our products appeal to various demographics around the world. We believe that our products appeal has been augmented by, and should continue to benefit from, growing trends toward casual attire and higher quality apparel.

## **Growth Strategy**

As we continue to expand through organic growth, internal initiatives and future acquisitions, we will incur additional material expenses. Two of the key areas in which such increased expenses will likely occur are cost of sales and new merchandise development. Also, as previously noted, in order to grow retail sales, we will have to open new retail locations and hire additional retail personnel to service new retail stores, which will involve an increase in occupancy expense and payroll. In order to grow the wholesale distribution channel, American Apparel will have to hire new sales personnel to service new geographic territories.

To support new merchandise development, expenses will increase as we design new products in existing and new categories. Ongoing infrastructure investment also may be required to support growth. This may include expenditures for new buildings, machinery and equipment, upgraded information systems and additions to our management team.

To reduce the impact of additional material expenses on earnings, we continue to look for ways to improve productivity of current manufacturing operations and to enhance other operating procedures. During 2009, we deployed a new reporting system which is expected to add substantial reporting and analytical capabilities to the corporate finance and accounting and resources.

One such initiative implemented during the year was the second phase of an enterprise resource planning (ERP) system, which included upgrading the financial accounting and wholesale distribution systems for our U.S. operations. We expect to realize gains in operation efficiencies in a number of enterprise-wide processes including inventory and production management.

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We have developed a growth strategy that is designed to capitalize on our strengths. The principal elements contributing to the success of this growth strategy are:

### *Store Expansion*

Our growth strategy and the success of our business depends in part on opening new American Apparel retail stores, the renewal of existing store leases on favorable terms that meet our financial targets, the remodeling of existing stores in a timely manner and the operation of these stores in a cost-efficient manner. We are committed to expanding our presence in the U.S. while significantly increasing our store footprint in markets throughout Europe and Asia. We expanded our store base, on a net basis, by 21 stores in 2009. As of March 15, 2010, we have signed leases for two additional store locations that we expect to open in 2010. We evaluate proposed sites based on traffic patterns, co-tenancies, average sales per square foot achieved by neighboring stores, lease economics, demographic characteristics and other factors considered important regarding the specific location. Our experience in international markets to date suggests that our brand concept is readily transferable to new geographies.

### *New Merchandise Introduction*

As we expand beyond our original product offering of T-shirts, we are increasing the variety of products available to our growing customer base. We have strategically expanded our product offering to include denim, sweaters, jackets and other products. We also intend to introduce new merchandise to complement these existing products, and attract new customers.

### *Continue In-Sourcing Manufacturing Activities*

We have explored making strategic acquisitions to consolidate our manufacturing operations and continue to produce high quality products. In December 2007, we expanded operations to include a new facility in South Gate, California where, commencing January 2008, we began cutting, sewing and garment dyeing a portion of our production. In May 2008, we acquired a fabric dyeing and finishing plant in Garden Grove, California, and have since added cutting, sewing and knitting operations to the facility. We believe that bringing certain elements of our production process in-house affords us the opportunity to exert higher quality control while also lowering production costs. We intend to continue to pursue strategic opportunities to further consolidate our operations while maintaining that production in the United States.

### *Enhance Information Systems Infrastructure*

We successfully completed the first phase of an enterprise resources planning ( ERP ) system in 2008. This phase included the conversion of our systems for manufacturing and warehouse operations, inventory management and control and wholesale operations. The resulting operating information and control systems have represented a substantial improvement over our legacy systems. We have also completed the second phase of the ERP implementation, which included upgrading the financial accounting and control systems for our U.S. operations. The second phase was completed in 2009. In conjunction with the implementation of this ERP system, we intend to maintain a continued focus on enhancing our information systems infrastructure and believe this approach will further optimize operations.

## **Manufacturing Operations**

We conduct all of our manufacturing operations in the Los Angeles metropolitan area, and principally at our cutting and sewing facility in downtown Los Angeles, California. In January 2008, we began cutting, sewing, and garment dyeing a portion of our output in a new facility in South Gate, California which was acquired in December 2007. In May 2008, we acquired an additional facility in Garden Grove, California with cutting, dyeing and sewing capacity. Operations in this facility began in June 2008.

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We purchase yarn which is sent to knitters to be knit into greige fabric, which is fabric that is not dyed or processed. We currently conduct a portion of our knitting operations in-house at our knitting facilities in Los Angeles and Garden Grove, California. We operate circular and flat knitting machines, producing jersey, piqué, fleece and ribbing using cotton and cotton/polyester yarns. We also utilize third-party commissioned knitters. Our knitting facilities knit approximately 80% of the total fabric used in our garments, and employed a staff of approximately 110 people, as of December 31, 2009.

Knitted greige fabric produced by our Los Angeles and Garden Grove facilities or by other commissioned knitters is batched for bleaching and dyeing and transported to our dyeing and finishing facilities, or other commissioned dye houses. In some cases, dyed fabric is transferred to subcontractors for fabric laundering. Our dyeing and finishing facilities in the Los Angeles metropolitan area dye approximately 99% of the total fabric used in our garments, and employed a staff of approximately 260 people, as of December 31, 2009.

Most fabric is shipped to our primary manufacturing facility in downtown Los Angeles, where it is inspected and then cut on manual and automated cutting tables, and subsequently sewn into finished garments. Some fabric is purchased directly from third parties, along with all trims. Garments are sewn by teams of sewing operators typically ranging from five to 15 operators, depending on the complexity of a particular garment. Each sewing operator performs a different sewing operation on a garment before passing it to the next operator. Sewing operators are compensated on a modified piece-rate basis. Quality control personnel inspect finished garments for defects and reject any defective product. We also manufacture some hosiery in-house at this facility, where it does knitting, inspection, and packing, and uses off-site contractors for washing and boarding. Approximately 3,500 employees were directly involved in the cutting, sewing, and hosiery operations at the downtown Los Angeles facility as of December 31, 2009.

We purchase yarn, certain fabrics and other raw materials from a variety of vendors during the course of a year. We do not have any major suppliers of raw materials that we rely on exclusively to support our production operations. The inputs that we use are produced competitively by a large number of potential suppliers. Since the inputs are commodities in nature, we believe that we could easily source our inputs from other vendors if the current suppliers were not able to meet our needs.

We maintain two warehouses, in addition to the warehouse and distribution center at our downtown Los Angeles facility, in the Los Angeles metropolitan area, where we store fabric rolls, trims, and finished goods. We also maintain warehouses in Montreal, Quebec and Neuss, Germany.

## **Retail**

As of December 31, 2009, our retail operations consisted of 281 retail stores in 20 countries, including the United States, Canada, Mexico, Brazil, United Kingdom, Ireland, Austria, Belgium, Germany, France, Italy, the Netherlands, Spain, Sweden, Switzerland, Israel, Australia, Japan, South Korea and China. We opened our first retail location in October 2003, in the Echo Park neighborhood of Los Angeles, California. Our retail operations principally target young adults aged 20 to 32 through our unique assortment of fashionable clothing and accessories and our compelling in-store experience. We have established a reputation with our customers, who are culturally sophisticated, creative, and independent-minded. The product offering includes women's and men's basic apparel and accessories, as well as new lines for children and pets. Stores average approximately 2,500-3,000 square feet of selling space. Our stores are located in large metropolitan areas, emerging neighborhoods, and select university communities.

We strive to instill enthusiasm and dedication in store management personnel and sales associates through regular communication with the stores. Store personnel receive minimum hourly compensation and receive discretionary incentive compensation based on meeting sales and profitability benchmarks.

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### **Wholesale**

Our wholesale operations sell to over a dozen authorized distributors and approximately 10,000 screen printers and advertising specialty companies. These screen printers and advertising specialty companies decorate our blank product with corporate logos, brands and other images. Our wholesale customers sell imprinted sportswear and accessories to a highly diversified range of end-consumers, including corporations, sporting venues, concert promoters, athletic leagues, and educational institutions, among others. In order to better serve customers, we allow customers to order products by the piece, by the dozen, or in full case quantities. We also, to a lesser extent, fulfill custom and private-label orders. We do not have any major customers that account for ten percent or more of total consolidated net sales.

To serve our wholesale customers, we operate a call center out of our Los Angeles headquarters. The call center is staffed with approximately 40 customer service representatives initiating sales calls, answering incoming phone calls, emails, and faxes, assisting customers in placing orders, checking stock levels, looking for price quotes or requesting adjustments. On average, the call center receives 800 calls daily and operates from Monday to Friday, 10am to 9pm, Eastern Standard Time ( EST ).

While we operate primarily on a make-to-stock basis, manufacturing and maintaining a sufficient inventory of products to meet demand, our in-house manufacturing capacity also allows us to fulfill large orders in a timely fashion. We capitalize on our inventory position by providing a quick turn-around on customer orders. Credit approved orders to be shipped by ground service are generally shipped the same day when received before 7:30pm EST while those to be shipped by air are generally shipped the same day when received by 6:30pm EST. The majority of our wholesale and internet customer orders are processed within these parameters. For these reasons, we do not typically maintain a large backlog of orders.

### **Online Consumer Sales**

Since 2004, we have operated an online consumer e-commerce website, which offers our products for purchase. This e-commerce website, located at [www.americanapparel.com](http://www.americanapparel.com), has localized storefronts for the United States, Canada, the United Kingdom, Continental Europe, Switzerland, Japan, Korea, and Australia. For segment reporting purposes U.S. online sales are included in the U.S. Wholesale business segment. Canada online sales are included in the Canada business segment, and overseas online sales are included in the International business segment.

### **Brand, Advertising, and Marketing**

Our advertising and direct marketing initiatives have been developed to elevate brand awareness, facilitate customer acquisition and retention and support key growth strategies. Our in-house creative team works to create edgy, high-impact, provocative ads which are produced year-round and are featured in leading national and local lifestyle publications, on billboards, and on specialty online websites. We maintain a photo studio at our headquarters. Content for our website and online store are also generated internally at American Apparel. While the primary intent of this advertising is to support our retail and online e-commerce operations, the wholesale business also benefits from the greater overall brand awareness generated by this advertising.

For our wholesale operations, we utilize industry trade shows to expand and enhance customer relationships, exhibit product offerings and share new promotions with customers. We participate in approximately two dozen trade shows annually. We also produce print catalogs of our wholesale products, designed to be of the standard of high-end consumer retail catalogs with attractive models, appealing photographs and a clear display of products.

### **Product Development**

We employ an in-house staff of designers and creative professionals to develop updated versions of timeless, iconic styles. Led by Dov Charney, this team takes its inspiration from classic styles of the past, as well as the latest emerging fashion trends. Our design team will often continue to update or renew a style long after its launch.

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### **Intellectual Property**

Our trademarks and service marks, and certain other trademarks, have been registered, or are the subject of pending trademark applications with the United States Patent and Trademark Office and with the registries of many foreign countries and/or are protected by common law. In the United States, we are the registered owner of the American Apparel®, Classic Girl®, Standard American®, Classic Baby® and Sustainable Edition® trademarks, among others.

### **Competition**

The specialty retail, online retail and wholesale apparel businesses are each highly competitive. The apparel industry is characterized by rapid shifts in fashion, consumer demand, and competitive pressures, resulting in both price and demand volatility. We believe that our emphasis on quality fashion essentials mitigates these factors.

Our retail operations compete on the basis of store location, the breadth, quality, style, and availability of merchandise, the level of customer service offered, and the price of goods for similar brand name quality. While we believe that the fit and quality of our garments, as well as the broad variety of colors and styles of casual fashion essentials that we offer, helps differentiate us, we compete against a wide variety of smaller, independent specialty stores, as well as department stores and national and international specialty chains. Companies that operate in this space include, but are not limited to, The Gap, Urban Outfitters, H&M, Uniqlo and Forever 21. Many of these companies have substantially greater name recognition than American Apparel. Many of these companies also have greater financial, marketing, and other resources when compared to American Apparel.

The wholesale business competes with numerous wholesale companies based on the quality, fashion, availability, and price of our wholesale product offering. These companies include Gildan, Activewear, Hanesbrands, Russell Athletic and Fruit of the Loom. Many of these companies have greater name recognition than American Apparel in the wholesale market. Many of these companies also have greater financial and other resources when compared to American Apparel.

Along with the competitive factors noted above, other key competitive factors for American Apparel's online e-commerce operations include the success or effectiveness of customer mailing lists, advertising response rates, merchandise delivery, web site design and web site availability. The online e-commerce operations compete against numerous web sites, many of which may have a greater volume of web traffic, and greater financial, marketing, and other resources.

### **Seasonality**

We experience seasonality in our operations. Historically, sales during the second and third fiscal quarters have generally been the highest, with sales during the first fiscal quarter the lowest. This reflects the combined impact of the seasonality of the wholesale and retail segments. Generally, our retail segment has not experienced the same pronounced sales seasonality as other retailers.

### **Employees**

As of December 31, 2009, we employed a work force of approximately 10,000 employees worldwide. To ensure our long-term success, we must attract, hire, develop, and retain skilled manufacturing, retail, sales, creative, and administrative employees, as well as executives. Competition for such employees can be intense.

We view our employees as long-term investments and adhere to a philosophy of providing employees with decent working conditions in a technology-driven environment which allows us to attain improved efficiency, while promoting employee loyalty. We provide a compensation structure and benefits package for manufacturing

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employees that includes above-market wages, company-subsidized health insurance, free English language classes, free massage, free parking, as well as other benefits. We also provide for a well-lit working environment that is properly ventilated and heated or cooled in our manufacturing facilities. These working conditions, as well as compensation and benefits packages, are key elements in achieving our desire to be an employer of choice in the Los Angeles area. None of our employees are covered by a collective bargaining agreement. We have never had a strike and we believe that our relations with our employees are excellent. We make diligent efforts to comply with all employment and labor regulations, including immigration laws, in the many jurisdictions in which we conduct operations. See Risk Factors We are subject to customs, advertising, consumer protection, zoning and occupancy and labor and employment laws that could require us to modify our current business practices and incur increased costs. Also see Risk Factors Litigation exposure could exceed expectations and have a material adverse effect on our financial condition and results of operations.

## **Information Technology**

We are committed to utilizing technology to enhance our competitive position. Our information systems provide data for production, merchandising, distribution, retail stores and financial systems. Our core business systems, which consist of both purchased and internally developed software, are accessed over a company-wide network providing corporate employees with access to key business applications. We dedicate a significant portion of our information technology resources to web services, which include the operation of our corporate website at [www.americanapparel.net](http://www.americanapparel.net) and our online retail site at [www.americanapparel.com](http://www.americanapparel.com).

To support continued growth, we have initiated a strategic review of our information systems. We have implemented an ERP system that replaced, enhanced and integrated many elements of our existing information systems. We operated a number of unrelated information technology systems that resulted in operational inefficiencies and in some cases increased costs. Implementation of the new ERP system was a multi-phased project with the first phase, covering manufacturing and production planning, having been completed during 2008, and the second phase, covering the financial accounting and wholesale distribution systems of our U.S. operations, was completed in the first half of 2009.

## **Environmental Regulation**

Our operations are subject to various environmental and occupational health and safety laws and regulations. Because we monitor, control and manage environmental issues, we believe we are in compliance in all material respects with the regulatory requirements of those jurisdictions in which our facilities are located. In line with our commitment to the environment as well as to the health and safety of its employees, we will continue to make expenditures to comply with these requirements, and does not believe that compliance will have a material adverse effect on our business.

## **Available Information**

We will make available on our website, [www.americanapparel.net](http://www.americanapparel.net), under Investor Relations free of charge, our annual reports on Form 10-K, as well as the latest quarterly reports on Form 10-Q, the latest reports on Form 8-K, the latest proxy statements and amendments to those documents as soon as reasonably practicable after we electronically file or furnish such materials to the SEC. You can also obtain copies of these materials at prescribed rates by writing to the Public Reference Section of the SEC at 100 F Street, N.E., Washington, D.C. 20549. You can obtain information on the operation of the public reference facilities by calling the SEC at 1-800-SEC-0330. The SEC also maintains a website at [www.sec.gov](http://www.sec.gov) that makes available reports, proxy statements and other information regarding American Apparel that we file electronically with it. By referring to our corporate website, [www.americanapparel.net](http://www.americanapparel.net), and our online retail website, [www.americanapparel.com](http://www.americanapparel.com), we do not incorporate these websites or their contents into this Form 10-K.



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***Purchases of retail apparel merchandise are generally discretionary and economic conditions may cause a decline in consumer spending which could adversely affect our business and financial performance.***

Our operations and performance depend significantly on worldwide economic conditions and their impact on levels of consumer spending, particularly in discretionary areas, such as apparel, which have recently deteriorated significantly in the United States and many other countries and regions and may remain depressed for the foreseeable future. Our business and financial performance, including our sales and the collection of our accounts receivable, may be adversely affected by the current decrease and any future decrease in economic activity in the United States or in other regions of the world in which we do business that could potentially cause a decline in consumer spending, including a reduction in the availability of credit, increased unemployment levels, higher fuel and energy costs, rising interest rates, adverse conditions in the housing markets, financial market volatility, recession, decreased access to credit, reduced consumer confidence in future economic conditions and political conditions, acts of terrorism, consumer perceptions of personal well-being and security and other macroeconomic factors affecting consumer spending behavior. Consumers are generally more willing to make discretionary purchases, including purchases of fashion products, during periods in which favorable economic conditions prevail. A decrease in consumer discretionary spending as a result of the current economic conditions may decrease the demand for our products. If consumer spending continues to slow down or decrease, we will not be able to improve our same store sales. In addition, reduced consumer spending may cause us to lower prices, suffer significant product returns from our customers or drive us to offer additional products at promotional prices, any of which would have a negative impact on gross profit.

Our ability to meet customers' demands depends, in part, on our ability to obtain timely and adequate delivery of materials, parts and components from our suppliers. The current global financial crisis may materially adversely affect the ability of our suppliers to obtain financing for significant purchases and operations. If certain key suppliers were to become capacity constrained or insolvent as a result of the financial crisis, it could result in a reduction or interruption in supplies or a significant increase in the price of supplies and adversely impact consumer spending and our financial results. Reduced revenues as a result of decreased consumer spending may also reduce our working capital for planned store improvements and to open additional stores in the manner that we have in the past. These and other economic factors could have a material adverse effect on demand for the American Apparel's products and on our financial condition and operating results. In addition, as a result of decreased revenues and working capital, we may be required to seek additional financing which may not be available on acceptable terms or at all. There can be no assurances that government responses to the disruptions in the financial markets will restore consumer confidence, stabilize such markets or increase liquidity and the availability of credit to consumers and businesses. We are not able to predict the duration and severity of the current disruption in the financial markets and adverse economic conditions in the United States and other countries. As a consequence, American Apparel's operating results for a particular period are difficult to predict, and, therefore, prior results are not necessarily indicative of results to be expected in future periods. Any of the foregoing effects could have a material adverse effect on our business, results of operations, and financial condition and could adversely affect our stock price.

***Disruptions in the global financial markets could adversely impact our liquidity and our ability to obtain financing, including by affecting the ability of our counterparties and others to perform their obligations to us.***

Our liquidity may be negatively impacted if one of our lenders under our credit agreements or other debt agreements, or another financial institution, suffers liquidity issues. In such an event, we may not be able to draw on all, or a substantial portion, of our debt agreements. The current economic environment could cause our lenders, counterparties and others to breach their obligations to us under our contracts with them, which could include failures of banks or other financial service companies to fund required borrowings under our debt agreements, to pay us amounts that may become due under our derivative contracts for interest rates and foreign currencies, and to pay us amounts that may become due under other agreements or our counterparties might limit or place burdensome conditions upon future transactions with our. Any of the foregoing could adversely impact our business, financial condition and results of operations.

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Also, if we attempt to obtain future financing, the credit market turmoil could negatively impact our ability to obtain such financing. In the event we need access to additional capital to pay our operating expenses, make payments on our indebtedness or pay capital expenditures, our ability to obtain such capital may be limited and the cost of any such capital may be significant. Our access to additional financing will depend on a variety of factors such as market conditions, the general availability of credit, the overall availability of credit to our industry, our credit ratings and credit capacity, as well as the possibility that lenders could develop a negative perception of our long-term or short-term financial prospects. If a combination of these factors were to occur, our internal sources of liquidity may prove to be insufficient, and in such case, we may not be able to successfully obtain additional financing on favorable terms or at all. In addition, the credit market turmoil could negatively impact certain of our customers and suppliers which could lead to a decrease in demand for our products and could have a material adverse impact on our financial condition and operating results.

Further, market conditions have resulted in severe downward pressure on the stock and credit markets, which could reduce the return available on invested corporate cash and thereby potentially increase funding obligations, which, if severe and sustained, could have material and adverse impacts on our results of operations and cash flows.

***American Apparel has significant indebtedness and a failure to generate significant cash flow could render it unable to service its obligations and may place it at a competitive disadvantage and limit its ability to pursue its expansion plans.***

As of December 31, 2009, American Apparel has substantial indebtedness, including \$6.2 million of borrowings under our revolving credit facility and \$65.6 million of borrowings under our facility with Lion (as defined below). The borrowings under our revolving credit facility bear interest at LIBOR plus 4.5% per annum, or prime rate (which rate can in no event be lower than LIBOR plus 2.5% per annum) plus 2.5% per annum, at our option, and the borrowings under our facility with Lion Capital LLP bear interest at 15% per annum (excluding debt discount), payable quarterly in arrears, in each case plus an additional 2% per annum if we are in default under such facility. Our ability to service this indebtedness is dependent on our ability to generate cash from internal operations sufficient to make required payments on such indebtedness. Our level of indebtedness has important consequences to you and your investment in our common stock. For example, our level of indebtedness may:

require us to dedicate a substantial portion of our cash flow from operations to pay interest and principal on our debt, which would reduce the funds available to use for operations, investments, future business opportunities and other general corporate purposes;

make it more difficult for us to satisfy our debt obligations, and any failure to comply with such obligations, including financial and other restrictive covenants, could result in an event of default under the agreements governing such indebtedness, which could lead to, among other things, an acceleration of our indebtedness or foreclosure on the assets securing our indebtedness, which could have a material adverse effect on our business or financial condition;

limit our ability to obtain additional financing, or to sell assets to raise funds, if needed, for working capital, capital expenditures, expansion plans and other investments, which may limit our ability to implement our business strategy;

result in higher interest expense if interest rates increase on our floating rate borrowings;

heighten our vulnerability to downturns in our business, the industry or in the general economy and limit our flexibility in planning for or reacting to changes in our business and the retail industry; or

reduce our ability to make acquisitions or take advantage of business opportunities as they arise or successfully carry out our plans to expand our store base, product offerings and sales channels.

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In addition, the terms of our indebtedness contain, and our future indebtedness may contain, various restrictive covenants that limit our management's discretion in operating our business, including limitations on capital expenditures. See The terms of our indebtedness contain various covenants that may limit our business activities below.

It is uncommon for companies involved in the retail apparel business to operate with such a high level of indebtedness due to the underlying volatility of this business. Despite the attendant risks, American Apparel may have to enter into new credit facilities, or possibly issue additional common stock, to finance its planned retail expansion. There can be no assurances that American Apparel will have access to any such financing on commercially reasonable terms or that it will be able to open its planned number of new stores in 2010 or beyond.

***If we are unable to gauge fashion trends and react to changing consumer preferences in a timely manner, our sales will decrease.***

Our success is largely dependent upon our ability to gauge the fashion tastes of our customers and to provide merchandise that satisfies customer demand in a timely manner. The retail apparel business fluctuates according to changes in consumer preferences dictated, in part, by fashion and season. To the extent we misjudge the market for our merchandise or the products suitable for our market, our sales will be adversely affected. Some of our past product offerings have not been well received by our customer base. Merchandise misjudgments could have a material adverse effect on our image with our customers and on our operating results. Fluctuations in the apparel retail market affect the inventory owned by apparel retailers, since merchandise usually must be manufactured in advance of the season and frequently before fashion trends are evidenced by customer purchases. In addition, the cyclical nature of the retail apparel business requires us to carry a significant amount of inventory, especially prior to peak selling seasons when we build up our inventory levels. As a result, we will be vulnerable to demand and pricing shifts and to suboptimal selection and timing of merchandise production. If sales do not meet expectations, too much inventory may lower planned margins. Our brand image may also suffer if customers believe we are no longer able to offer the latest fashion. The occurrence of these events could adversely affect our financial results by decreasing sales.

***We operate in the highly competitive retail industry and our market share may be adversely impacted at any time by the significant number of competitors in our industry that may compete more effectively than we can.***

The apparel industry is characterized by rapid shifts in fashion, consumer demand and competitive pressures, resulting in both price and demand volatility. The retail apparel industry, in general, and the imprintable apparel market, specifically, is fragmented and highly competitive. Prices of certain products we manufacture, particularly T-shirts, are determined based on market conditions, including the price of raw materials. There can be no assurance that we will be able to compete successfully in the future. We compete with national and local department stores, specialty and discount store chains, independent retail stores and Internet businesses that market similar lines of merchandise, including The Gap, Urban Outfitters, H&M, Uniqlo and Forever 21. Many of our competitors are, and many of our potential competitors may be, larger, have substantially greater name recognition than American Apparel and have greater financial, marketing and other resources and, therefore, may be able to adapt to changes in customer requirements more quickly, devote greater resources to the marketing and sale of their products, generate greater national brand recognition or adopt more aggressive pricing policies than we can. We face a variety of competitive challenges, including:

anticipating and quickly responding to changing consumer demands;

maintaining favorable brand recognition and effectively marketing our products to consumers in diverse markets;

developing innovative, high-quality products in sizes, colors and styles that appeal to consumers;

sourcing raw materials and manufacturing merchandise efficiently;

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pricing our products to remain competitive while achieving a customer perception of comparatively higher value;

providing strong and effective marketing support; and

maintaining high levels of consumer traffic to our retail stores.

We also face competition in European, Asian and Canadian markets from established regional and national chains. Our success in these markets depends on determining a sustainable profit formula to build brand loyalty and gain market share in these challenging retail environments. If our international business is not successful or if we cannot effectively take advantage of international growth opportunities, our results of operations could be adversely affected.

The wholesale business competes with numerous wholesale companies based on the quality, fashion, availability, and price of our wholesale product offerings. These companies include Gildan Activewear, Hanesbrands, Russell Athletic and Fruit of the Loom. Many of these companies have greater name recognition than American Apparel in the wholesale market. Many of these companies also have greater financial and other resources when compared to American Apparel. If we cannot successfully compete with these companies, our results of operations could be adversely affected.

***We depend on key personnel, and our ability to grow and compete will be harmed if we do not retain the continued services of such personnel, or we fail to identify, hire and retain additional qualified personnel.***

We depend on the efforts and skills of our management team, and the loss of services of one or more members of this team, each of whom have substantial experience in the apparel industry, could have an adverse effect on our business. Our senior officers closely supervise all aspects of our business, in particular the design and production of merchandise and the operation of our stores. Because we have never operated as a public company prior to the Acquisition, we need to enhance our management team, including those responsible over financial reporting, to address the reporting requirements of a public company. If we are unable to hire and retain qualified management or if any member of our management leaves, such departure could have an adverse effect on our operations and could adversely affect our ability to design new products and to maintain and grow the distribution channels for our products. In particular, we believe we have benefited substantially from the leadership and strategic guidance of Dov Charney. The loss of Dov Charney would be particularly harmful as he is considered intimately connected to our brand identity and is the principal driving force behind our core concepts and designs. He is also the driving force behind our growth strategy.

Our ability to anticipate and effectively respond to changing fashion trends depends in part on our ability to attract and retain key personnel in our design, merchandising and marketing areas, and other functions. In addition, if we experience material growth, we will need to attract and retain additional qualified personnel. The market for qualified and talented design and marketing personnel in the apparel industry is intensely competitive, and we cannot be sure that we will be able to attract and retain a sufficient number of qualified personnel in future periods. If we are unable to attract or retain qualified personnel as needed, our growth will be hampered and our operating results could be materially adversely affected.

***We rely heavily on immigrant labor, and changes in immigration laws or enforcement actions or investigations under such laws could significantly adversely affect our labor force, manufacturing capabilities, operations and financial results.***

We rely heavily on immigrant labor. Adverse changes to existing laws and regulations applicable to employment of immigrants, enforcement requirements or practices under those laws and regulations, and inspections or investigations by immigration authorities or the prospects or rumors of any of the foregoing, even if no violations exist, could negatively impact the availability and cost of personnel and labor to American Apparel. As a result, we could experience very substantial turnover of employees on short or no notice, which

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could result in manufacturing and other delays. We may also have difficulty attracting or hiring new employees in a timely manner, resulting in further delays. These delays could materially adversely affect our revenues and ability to complete. If we are not able to continue to attract and retain sufficient employees, our manufacturing capabilities, operations and financial results would be adversely affected.

*Our growth strategy relies in part on the opening of new stores and the remodeling of existing stores periodically which may strain our resources and adversely impact the performance of our existing store base.*

Our growth strategy and the success of our business depends in part on the opening of new American Apparel retail stores, the renewal of existing store leases on terms that meet our financial targets, the remodeling of existing stores in a timely manner and the operation of these stores in a cost-efficient manner. Successful implementation of this portion of our growth strategy depends on a number of factors including, but not limited to, our ability to:

identify and obtain suitable store locations and negotiate acceptable leases for these locations;

complete store design and remodeling projects on time and on budget;

manage and expand our infrastructure to accommodate growth;

generate sufficient operating cash flows or secure adequate capital on commercially reasonable terms to fund our expansion plan and remain in compliance with the capital expenditure covenant and other relevant covenants in our credit facilities that may limit our ability to fund such expansion plans;

manage inventory effectively to meet the needs of new and existing stores on a timely basis;

foster current relationships and develop new relationships with vendors that are capable of supplying a greater volume of merchandise;

avoid construction delays and cost overruns in connection with the build-out of new stores;

supply our stores with proper types and quantities of merchandise; and

hire, train and retain qualified store managers and sales people.

Our plans to expand our store base and to remodel certain existing stores may not be successful and the implementation of these plans may not result in an increase in our revenues even though they increase our costs. Additionally, new stores that we open may place increased demands on our existing financial, operational, managerial and administrative resources, which could cause us to operate less effectively.

Furthermore, it is possible that by opening a new store in an existing market, we could adversely affect the previously existing stores in that market by drawing away traffic from the previously existing stores. Our new stores may not be immediately profitable and, as such, we may incur losses until these stores become profitable. Any failure to successfully open and operate new stores would adversely affect our results of operations.

*The market for real estate in desirable retail store locations is competitive, which could hamper our ability to open new stores.*

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Our ability to obtain real estate to open new stores in desirable locations depends upon the availability of real estate that meets our criteria, which includes, among other items, projected foot traffic, square footage, demographics and whether we are able to negotiate lease terms that meet our operating budget. In addition, we must be able to effectively renew our existing store leases from time to time. Failure to secure real estate in desirable locations on economically beneficial terms or to renew leases on existing store locations on economically beneficial terms could have a material adverse effect on our results of operations.

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***Our plans to expand our product offerings and sales channels may not be successful, and implementation of these plans may divert our operational, managerial and administrative resources, which could impact our competitive position.***

Our ability to grow our existing brand and develop or identify new growth opportunities depends in part on our ability to appropriately identify, develop and effectively execute strategies and initiatives. Failure to effectively identify, develop and execute strategies and initiatives may lead to increased operating costs without offsetting benefits and could have a material adverse effect on our results of operations. These plans involve various risks discussed elsewhere in these risk factors, including:

implementation of these plans may be delayed or may not be successful;

if our expanded product offerings and sales channels fail to maintain and enhance our distinctive brand identity, our brand image may be diminished and our sales may decrease;

if we fail to expand our infrastructure, including by securing desirable store locations at reasonable costs and hiring and training qualified employees, we may be unable to manage our expansion successfully; and

implementation of these plans may divert management's attention from other aspects of our business and place a strain on our management, operational and financial resources, as well as our information systems.

In addition, our ability to successfully carry out our plans to expand our product offerings and our sales channels may be affected by, among other things, economic and competitive conditions, changes in consumer spending patterns and changes in consumer preferences and fashion trends. Our expansion plans could be delayed or abandoned, could cost more than anticipated and could divert resources from other areas of our business; any of which could impact our competitive position and reduce our revenue and profitability.

***Expanding our business internationally is an important part of our overall growth strategy and our success in this regard is subject to numerous risks, any of which could delay or prevent successful penetration into international markets.***

As we expand internationally, we need to effectively and efficiently open and operate stores in international locations. Our international growth will be limited unless we can:

identify suitable markets and obtain suitable sites for store locations;

negotiate acceptable lease terms;

complete store design and remodeling projects on time and on budget;

hire, train and retain competent store personnel;

gain acceptance from foreign customers;

manage inventory effectively to meet the needs of new and existing stores on a timely basis;

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manage and expand infrastructure to accommodate growth;

generate sufficient operating cash flows or secure adequate capital on commercially reasonable terms to fund our expansion plan;

manage foreign exchange risks effectively;

address existing and changing legal, regulatory and political environments in target foreign markets; and

manage international growth, if any, in a manner that does not unduly strain our financial, operating and management resources.



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We anticipate that we will incur significant costs related to starting up and maintaining additional foreign operations. Costs may include, and will not be limited to, obtaining prime locations for stores, setting up foreign offices and distribution facilities and hiring experienced management. These increased demands may cause us to operate our business less effectively, which in turn could cause deterioration in the performance of our stores. Furthermore, our ability to conduct business in international markets may be affected by legal, regulatory, political and economic risks.

***If we fail to maintain the value and image of our brand, our sales are likely to decline.***

Our success depends on the value and image of the American Apparel brand. The American Apparel name is integral to our business as well as to the implementation of our strategies for expanding our business. Maintaining, promoting and positioning our brand depend largely on the success of our marketing and merchandising efforts and our ability to provide a consistent, high quality customer experience. Our brand could be adversely affected if we fail to achieve these objectives or if our public image or reputation or those of our senior personnel were to be tarnished by negative publicity. Any of these events could result in decreases in sales.

***We expect to experience fluctuations in our comparable store sales and margins, which could cause our earnings to decline and make it difficult to gauge our growth at any specific period of time.***

Our inability to maintain recent levels of comparable store sales could cause our earnings to decline. Our success depends, in part, upon our ability to improve sales, as well as gross margins and operating margins, at American Apparel's existing stores. American Apparel's comparable store sales have fluctuated significantly in the past on an annual, quarterly and monthly basis, and we expect that they will continue to fluctuate in the future. A variety of factors affect comparable store sales, including fashion trends, competition, current economic conditions, pricing, inflation, the timing of release of new merchandise and promotional events, changes in our merchandise mix, the success of marketing programs, timing and level of markdowns and weather conditions. These factors may cause our comparable store sales results to differ materially from prior periods and from our expectations, which could cause a decrease in our earnings. Our ability to deliver strong comparable store sales results and margins depends in large part on accurately forecasting demand and fashion trends, selecting effective marketing techniques, providing an appropriate mix of merchandise for our customer base, managing inventory effectively, using more effective pricing strategies, and optimizing store performance.

***Our failure to adequately protect our trademarks and other intellectual property rights could diminish the value of our brand and reduce demand for our merchandise.***

American Apparel trademarks and service marks, and certain other trademarks, have been registered, or are the subject of pending trademark applications with the United States Patent and Trademark Office and with the registries of many foreign countries and/or are protected by common law. In the United States, American Apparel is the registered owner of the American Apparel®, Classic Girl Standard American®, Classic Baby®, and Sustainable Edit® trademarks, among others. Our products are noted for their quality and fit, and our edgy, distinctive branding has differentiated it in the marketplace. As such, the trademark and variations thereon are valuable assets that are critical to our success. We intend to continue to vigorously protect our trademark and brand against infringement, but we may not be successful in doing so. In addition, the laws of certain foreign countries may not protect proprietary rights to the same extent as do the laws of the United States. The unauthorized reproduction or other misappropriation of our trademark would diminish the value of our brand, which could reduce demand for our products or the prices at which we can sell our products.

***Our ability to attract customers to our stores depends heavily on the success of the shopping areas in which they are located.***

In order to generate customer traffic, we locate many of our stores in prominent locations within successful shopping areas. Net sales at these stores are partly dependent on the volume of traffic in those shopping areas.

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Our stores benefit from the ability of a shopping area's other tenants to generate consumer traffic in the vicinity of our stores and the continuing popularity of the shopping areas. We cannot control the availability or cost of appropriate locations within existing or new shopping areas, competition with other retailers for prominent locations or the success of individual shopping areas. In addition, factors beyond our control impact shopping area traffic, such as economic conditions nationally or in a particular area, competition from internet retailers, changes in consumer demographics in a particular market, the closing or decline in popularity of other stores in the shopping areas where our stores are located, deterioration in the financial conditions of the operators of the shopping areas or developers and consumer spending levels. The slowdown in the U.S. economy has negatively affected consumer spending and reduced shopping area traffic. A significant decrease in shopping area traffic could have a material adverse effect on our financial condition or results of operations. Furthermore, in pursuing its growth strategy, we will be competing with other retailers for prominent locations within the same successful shopping areas. If we are unable to secure these locations or unable to renew store leases on acceptable terms as they expire from time-to-time we may not be able to continue to attract the number or quality of customers we normally have attracted or would need to attract to sustain our projected growth. All these factors may also impact our ability to meet our growth targets and could have a material adverse effect on our financial condition or results of operations.

***Fluctuations in our results of operations from quarter to quarter could have a disproportionate effect on our overall financial condition and results of operations.***

We experience seasonal fluctuations in revenues and operating income. Historically, sales during the second and third fiscal quarters have generally been the highest, with sales during the first fiscal quarter being the lowest. Any factors that harm our operating results for the second and third fiscal quarters, including adverse weather or unfavorable economic conditions, could have a disproportionate effect on our results of operations for the entire fiscal year.

In order to prepare for our peak selling season, we must produce and keep in stock more merchandise than we would carry at other times of the year. Any unanticipated decrease in demand for our products during our peak selling season could require us to sell excess inventory at a substantial markdown, which could reduce our net sales and gross profit.

***The terms of our indebtedness contain various covenants that may limit our business activities.***

The terms of our indebtedness contain, and our future indebtedness may contain, various restrictive covenants that limit our management's discretion in operating our business. In particular, these agreements include, or may include, covenants relating to limitations on:

dividends on, and redemptions and repurchases of, capital stock;

payments on subordinated debt;

liens and sale-leaseback transactions;

loans and investments;

debt and hedging arrangements;

mergers, acquisitions and asset sales;

transactions with affiliates;

disposals of assets;

changes in business activities conducted by us and our subsidiaries; and

capital expenditures, including to fund future store openings.

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In addition, our indebtedness requires us to comply with certain financial ratios and maintain certain amounts of unused availability under our revolving credit facility. Such restrictions could limit our ability to respond to market conditions, to provide for unanticipated capital investments or to take advantage of business or acquisition opportunities. See Risk Factors Failure of American Apparel to remain in compliance with certain financial covenants under its financing arrangements could result in the acceleration of its debt payment obligations. Also see Management's Discussion and Analysis of Financial Condition and Results of Operations Debt Agreements .

Compliance with these covenants and these ratios may prevent us from pursuing opportunities that we believe would benefit our business, including opportunities that we might pursue as part of our plans to expand our store base, our product offerings and sales channels.

***Failure of American Apparel to remain in compliance with certain financial covenants under its financing arrangements could result in the acceleration of its debt repayment obligations.***

The financing agreements between us and our lenders contain certain financial covenants relating to our capital expenditure limitations, availability under its revolving credit facility and debt to EBITDA ratios. Failure of American Apparel to maintain compliance with any of these financial covenants can result in American Apparel being unable to borrow under its revolving credit facility, which it utilizes to access its working capital, and may adversely affect the ability of American Apparel to finance and continue its operations. Such a failure could also result in an increase in the interest rate payable under the financing arrangements and acceleration of the outstanding debt in its entirety, and may adversely affect the ability of American Apparel to obtain financing that may be necessary to effectively operate its business and grow the business going forward.

***Substantially all of our assets are used to secure our credit facilities, certain term loans and equipment leasing agreements.***

Our credit facilities are secured by substantially all of our assets including cash, inventory and accounts receivable, and our second lien term loan facility is also secured by substantially all assets of our. All leasing agreements are secured by equipment provided by the leasing arrangement. In the event of a default on these agreements, substantially all of the assets of American Apparel could be subject to liquidation by the creditors, which liquidation could result in no assets being left for the stockholders after the creditors receive their required payment.

***Cost increases in the materials or labor used to manufacture our products could negatively impact our business and financial condition.***

The manufacture of our products is labor intensive and utilizes raw materials supplied by third parties. An important part of American Apparel branding and marketing is that our products are made in the United States. The Federal Trade Commission has stated that for a product to be called "Made in USA", or claimed to be of domestic origin without qualifications or limits on the claim, the product must be all or virtually all made in the U.S. The term "United States" includes the 50 states, the District of Columbia, and the U.S. territories and possessions. "All or virtually all" means that all significant parts and processing that go into the product must be of U.S. origin. That is, the product should contain no - or negligible - foreign content. We meet the FTC's "Made in USA" standard and from the knitting process to the final sewing of a garment, all of the processes are conducted in the U.S., either directly by us in our knitting, manufacturing, dyeing and finishing facilities located in Los Angeles or through commission knitters, dyers and sewers in the Los Angeles metropolitan area and other regions in the U.S. If the cost of labor materially increases, our financial results could be materially adversely affected and our ability to compete against companies with lower labor costs could be hampered. Material increases in labor costs in the United States could also force us to move all or a portion of our manufacturing overseas, which could adversely affect the American Apparel brand identity. Similarly, increases in the prices we pay to the suppliers of the raw materials used in the manufacturing of our products could adversely affect our financial condition and ability to compete and could force us to seek to offset increased raw material costs by relocating all or a portion of our manufacturing overseas to locations with lower labor costs.

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***Unionization of employees at our facilities could result in increased risk of work stoppages and high labor costs.***

Our employees are not party to any collective bargaining agreement or union. If employees at our manufacturing or distribution facilities were to unionize, our relationship with our employees could be adversely affected. We would also face an increased risk of work stoppages and higher labor costs. Accordingly, unionization of our employees could have a material adverse impact on our operating costs and financial condition and could force us to raise prices on our products, curtail operations and/or relocate all or a portion of our operations overseas.

***We are subject to customs, advertising, consumer protection, zoning and occupancy and labor and employment laws that could require us to modify our current business practices and incur increased costs.***

We are subject to numerous regulations, including customs, truth-in-advertising, consumer protection and zoning and occupancy laws and ordinances that regulate retailers generally and/or govern the importation, promotion and sale of merchandise and the operation of retail stores and warehouse facilities. We also are subject to numerous federal and state labor laws, such as minimum wage laws and other laws relating to employee benefits. If these regulations were to change or were violated by our management, employees, suppliers, buying agents or trading companies, the costs of certain goods could increase, or we could experience delays in shipments of our goods, be subject to fines or penalties, or suffer reputational harm, which could reduce demand for our merchandise and hurt our business and results of operations. In addition, changes in federal and state minimum wage laws and other laws relating to employee benefits could cause us to incur additional wage and benefits costs, which could adversely affect our profitability. We are currently defending one wage and hour suit. Should this matter be decided against us, we could incur substantial liability, experience an increase in similar suits, and suffer reputational harm. We are unable to predict the financial outcome of this matter at this time, and any views we form as to the viability of this claim or the financial exposure in which it could result may change. No assurance can be made that this matter, either individually or together with the potential for similar suits and reputational harm, will not result in a material financial exposure, which could have a material adverse effect upon our financial condition and results of operations. See the section entitled **Item 3. Legal Proceedings** for a more detailed discussion of our pending litigation.

Legal requirements are frequently changed and subject to interpretation, and we are unable to predict the ultimate cost of compliance with these requirements or their effect on our operations. We may be required to make significant expenditures or modify our business practices to comply with existing or future laws and regulations, which may increase our costs and materially limit our ability to operate our business.

***Current environmental laws, or laws enacted in the future, may harm our business.***

We are subject to federal, state and local laws, regulations and ordinances that govern activities or operations that may have adverse environmental effects (such as emissions to air, discharges to water, and the generation, handling, storage and disposal of solid and hazardous wastes). We are also subject to laws, regulations and ordinances that impose liability for the costs of clean up or other remediation of contaminated property, including damages from spills, disposals or other releases of hazardous substances or wastes, in certain circumstances without regard to fault. Certain of our operations routinely involve the handling of chemicals and wastes, some of which are or may become regulated as hazardous substances. Our product design and procurement operations must comply with new and future requirements relating to the materials composition of our products. If we fail to comply with the rules and regulations regarding the use and sale of such regulated substances, we could be subject to liability. The costs and timing of costs under environmental laws are difficult to predict.

As is the case with manufacturers in general, if a release of hazardous substances occurs on or from its properties or any associated offsite disposal locations, or if contamination from prior activities is discovered at any of its properties, We may be held liable. The amount of such liability could be material.

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***Our manufacturing operations are located and will be located in higher-cost geographic locations, placing us at a possible disadvantage to competitors that have a higher percentage of their manufacturing operations overseas.***

Despite the general industry-wide migration of manufacturing operations to lower-cost locations, such as Central America, the Caribbean Basin and Asia, our textile manufacturing operations are still located in the United States, which is a higher-cost location relative to these offshore locations. In addition, our competitors generally source or produce a greater portion of their textiles from regions with lower costs than American Apparel, which also places us at a cost disadvantage. Our competitors' lower costs of production may allow them to offer their products at a lower price than our selling prices for similar products. This could force us to lower our margins or to compete more vigorously with non-price competitive strategies to preserve our margins and sales volume.

***Our reliance on operational facilities located in the same vicinity makes our business susceptible to disruptions or adverse conditions affecting the location of our facilities.***

We conduct all of our manufacturing operations in the Los Angeles metropolitan area. Specifically, we operate principally out of its 800,000 square foot facility in downtown Los Angeles, which houses our executive offices, as well as our cutting, sewing, and distribution operations. We also operate a knitting facility in Los Angeles, California; a cutting, sewing, garment dyeing and finishing facility in South Gate, California; a fabric dyeing and finishing facility in Hawthorne, California, a cutting, sewing, fabric dyeing and finishing facility in Garden Grove, California; as well as a warehouse facility in Commerce, California and Los Angeles, California. As a result, our operations are susceptible to local and regional factors, such as accidents, system failures, economic and weather conditions, natural disasters, and demographic and population changes, as well as other unforeseen events and circumstances.

Southern California is particularly susceptible to earthquakes. Any significant interruption in the operation of any of these facilities could reduce our ability to receive and process orders and provide products and services to our stores and customers, which could result in lost sales, cancelled sales and a loss of loyalty to our brand. Furthermore, if there were a major earthquake, we may have to cease operations for a significant portion of time due to damages to our factory and the inability to deliver products to our distribution centers.

***Third party failure to deliver merchandise to stores and customers could result in lost sales or reduced demand for our merchandise.***

The efficient operation of our stores and wholesale business depends on the timely receipt of merchandise from our distribution centers. Independent third party transportation companies deliver a substantial portion of our merchandise to our stores. These shippers may not continue to ship our products at current pricing or terms. These shippers may employ personnel represented by labor unions. Disruptions in the delivery of merchandise or work stoppages by employees or contractors of these third parties could delay the timely receipt of merchandise, which could result in cancelled sales, a loss of loyalty to our brand and excess inventory. There can be no assurance that such stoppages or disruptions will not occur in the future. Any failure by these third parties to respond adequately to our distribution needs would disrupt our operations and could have a material adverse effect on our financial condition and results of operations.

Timely receipt of merchandise by our stores and our customers may also be affected by factors such as inclement weather, natural disasters and acts of terrorism. We may respond by increasing markdowns or initiating marketing promotions, which would decrease our gross profits and net income.

***Elimination or scaling back of U.S. import protections would weaken an important barrier to the entry of foreign competitors who produce their merchandise in lower labor cost locations. This could place us at a disadvantage to those competitors.***

Our products are subject to foreign competition. Foreign producers of apparel often have significant labor cost advantages, which can enable them to sell their products at relatively lower prices. However, in the past,

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foreign competitors have been faced with significant U.S. government import restrictions in the form of tariffs and quotas. The extent of import protection afforded to domestic apparel producers has been, and is likely to remain, subject to political considerations, and is therefore unpredictable. Given the number of foreign low cost producers, the substantial elimination or scaling back of the import protections that protect domestic apparel producers such as American Apparel could have a material adverse effect on our business and the financial condition and results of operation.

***Because we utilize foreign suppliers and sell into foreign markets, we are subject to numerous risks associated with international business that could increase our costs or disrupt the supply of our products, resulting in a negative impact on our business and financial condition.***

Our international operations subject us to risks, including:

economic and political instability;

restrictive actions by foreign governments;

greater difficulty enforcing intellectual property rights and weaker laws protecting intellectual property rights,

changes in import duties or import or export restrictions;

fluctuations in currency exchange rates, which could negatively affect profit margins;

timely shipping of product and unloading of product through West Coast ports, as well as timely truck delivery to American Apparel's warehouses;

complications complying with the laws and policies of the United States affecting the exportation of goods, including duties, quotas, and taxes; and

complications in complying with trade and foreign tax laws.

These and other factors beyond our control could disrupt the supply of our products, influence the ability of our suppliers to export our products cost-effectively or at all, inhibit our suppliers' ability to procure certain materials and increase our expenses, any of which could harm our business, financial condition and results of operations.

***Litigation exposure could exceed expectations and have a material adverse effect on our financial condition and results of operations.***

We are subject to regulatory inquiries, investigations, claims and suits. We are currently defending one wage and hour suit, one sexual harassment suit and responding to several allegations of discrimination and/or harassment that have been filed with the Equal Employment Opportunity Commission or state counterpart agencies. In the event one or more of these matters are decided against us, we could not only incur substantial liability but also experience an increase in similar suits and suffer reputational harm. Furthermore, the previous insurer for our employment practices liability insurance policy alleges that the sexual harassment suit is not covered by that insurance policy. We are unable to predict the financial outcome that could result from these matters at this time and any views we form as to the viability of these claims or the financial exposure in which they could result could change from time to time as the matters proceed through their course, as facts are established and various judicial determinations are made. No assurance can be made that these matters will not have material financial exposure, which together with the potential for similar suits and reputational harm, could have a material adverse effect upon our financial condition and results of operations. See the section entitled *Item 3. Legal Proceedings* for a more detailed discussion of American Apparel's pending litigation.

*The process of upgrading our information technology infrastructure may disrupt our operations.*

We are increasingly dependent on information systems to operate our website, process transactions, respond to customer inquiries, manage inventory and production, purchase, sell and ship goods on a timely basis and



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maintain cost-efficient operations. We have performed an evaluation of our information technology systems and requirements and have implemented upgrades to our information technology systems supporting the business. These upgrades involve replacing legacy systems with successor systems, making changes to legacy systems or acquiring new systems with new functionality. There are inherent risks associated with replacing and changing these systems, including accurately capturing data and system disruptions. We may experience operational problems with our information systems as a result of system failures, viruses, computer hackers or other causes. Any material disruption or slowdown of our systems, including a disruption or slowdown caused by our failure to successfully upgrade our systems, could cause information, including data related to customer orders, to be lost or delayed which could especially if the disruption or slowdown occurred during the holiday season result in delays in the delivery of merchandise to our stores and customers or lost sales, which could reduce demand for our merchandise and cause our sales to decline.

Moreover, we may not be successful in developing or acquiring technology that is competitive and responsive to the needs of our customers and might lack sufficient resources to make the necessary investments in technology to compete with our competitors. Accordingly, if changes in technology cause our information systems to become obsolete, or if our information systems are inadequate to handle our growth, we could lose customers.

***We have potentially adverse exposure to credit risks on our wholesale sales.***

We are exposed to the risk of financial non-performance by our customers, primarily in our wholesale business. Sales to wholesale customers represented approximately 25.3% of total net sales for the year ended December 31, 2009. Our extension of credit involves considerable use of judgment and is based on an evaluation of each customer's financial condition and payment history. We monitor our credit risk exposure by periodically obtaining credit reports and updated financials on its customers. We maintain an allowance for doubtful accounts for potential credit losses based upon historical trends and other available information. However, delays in collecting or the inability to collect on sales to significant customers or a group of customers could have a material adverse effect on our results of operations.

***A failure in our Internet operations could significantly disrupt our business and lead to reduced sales and reputational damage.***

Our online retail operations accounted for approximately 6.7% of net sales for the year ended December 31, 2009 and are subject to numerous risks that could have a material adverse effect on our operational results. Risks to online revenue include, but are not limited to, the following:

changes in consumer preferences and buying trends relating to Internet usage;

changes in required technology interfaces;

web site downtime;

difficulty in recreating the in-store experience on a web site; and

risks related to the failure of the systems that operate the web sites and their related support systems, including computer viruses, theft of customer information, telecommunication failures and electronic break-ins and similar disruptions.

Our failure to successfully respond to these risks and uncertainties could reduce Internet sales and damage our brand's reputation.

***We have identified certain material weaknesses in our internal control over financial reporting as of December 31, 2009.***

We have identified material weaknesses in our internal control over financial reporting as of December 31, 2009, as further described in Item 9A of this Annual Report on Form 10-K. These material weaknesses relate to our control environment and our financial controls and reporting process.



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A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis. In addition, due to the identified material weaknesses, management has concluded that as of December 31, 2009, our disclosure controls and procedures were ineffective. The existence of material weaknesses could adversely affect our ability to report our financial condition and results of operations accurately and on a timely basis and, as a result, we may be unable to timely meet our reporting obligations with the SEC. The existence of material weaknesses also could adversely affect the market price of our common stock and subject us to sanctions or investigations by the NYSE Amex, the SEC and other regulatory authorities.

***We are currently being audited by government tax agencies regarding our operating activities in previous periods which may result in an assessment of a material amount, the payment of which may adversely impact our financial conditions and operations.***

As of December 31, 2009, we are being audited by Government agencies in various jurisdictions in regards to sales, VAT, income, and other taxes for certain previous years. We believe that we properly assess and remit all required sales, VAT, income, and other taxes in the applicable jurisdictions and, we account for any uncertain tax position or tax contingency in accordance with the provisions of ASC 740 Income Taxes or ASC 450 Contingencies, respectively. We have accrued approximately \$6.5 million and \$1.9 million as of December 31, 2009 and 2008, respectively, for all uncertain income tax positions and non-income tax contingencies. In determining the amounts related to the uncertain tax position, we recognize the benefits that have a greater than 50% probability of being sustained under audit. The actual amount upheld under audit with the relevant taxing authorities could be materially different than our estimates. At December 31, 2009 and 2008, we have recognized approximately \$5.1 million and \$0.9 million, respectively, related to uncertain income tax positions. For non-income tax contingencies, we estimate the probability of the related exposure and record a reserve if it is probable that a contingent liability exists. At December 31, 2009 and 2008, we have recorded \$1.4 million and \$1.0 million, respectively, related to non-income tax related tax contingencies.

***There will be a substantial number of shares of American Apparel's common stock available for sale in the future that may increase the volume of common stock available for sale in the open market and may cause a decline in the market price of American Apparel's common stock.***

The consideration issued in the Acquisition to the American Apparel stockholders included 37,258,065 shares of American Apparel common stock that was issued at the closing to Dov Charney. The resale of these shares has not been registered and these shares are restricted securities under the securities laws. In addition, all of these shares are subject to lock-up agreements and cannot be sold publicly, in the absence of our consent, until the expiration of the restricted period under the lock-up agreement in December 2013 (which period may be shortened to December 2010 upon the occurrence of certain events). The presence of these additional shares of common stock eligible for trading in the public market may have an adverse effect on the market price of American Apparel's common stock.

In addition, we have outstanding warrants exercisable to purchase an aggregate of 17 million shares of its common stock, representing on an as-converted basis approximately 18% of the outstanding common stock (after giving effect to the issuance of the shares underlying such warrants). SOF Investments, L.P. Private IV (SOF) holds a warrant, expiring on December 19, 2013, to purchase one million shares of American Apparel common stock at an exercise price of \$3.00 per share, which exercise price is subject to adjustment under certain circumstances. As a result of the issuance of the Lion Warrant, the exercise price of the SOF Warrant was adjusted to \$2.816 per share. In addition, Lion Capital (Guernsey) II Limited (Lion) holds a warrant, expiring on March 13, 2016, to purchase 16 million shares of American Apparel common stock at an exercise price of \$2.00 per share, which exercise price is subject to adjustment under certain circumstances.

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***Our stock price may be volatile.***

Our stock price may fluctuate substantially as a result of quarter to quarter variations in the actual or anticipated financial results of our or other companies in the retail industry or markets served by our. In addition, the stock market has experienced price and volume fluctuations that have affected the market price of many retail and other stocks and that have often been unrelated or disproportionate to the operating performance of these companies. Failure to meet the expectations of investors, security analysts or credit rating agencies in one or more future periods could reduce the market price of our common stock and cause our credit ratings to decline.

***If we are unable to maintain our listing of American Apparel's securities on the NYSE Amex or any stock exchange, it may be more difficult for our stockholders to sell their securities.***

Our common stock is currently traded on the NYSE Amex. If for any reason the NYSE Amex should delist our securities from trading on its exchange, and we are unable to obtain listing on the Nasdaq or another national securities exchange, we could face significant material adverse consequences, including:

a limited availability of market quotations for our securities;

a limited amount of news and analyst coverage for our Company;

a decreased ability to issue additional securities or obtain additional financing in the future; and

a determination that its common stock is a penny stock, if the securities sell for a substantial period of time at a low price per share which would require brokers trading in its common stock to adhere to more stringent rules, possibly resulting in a reduced level of trading activity in the secondary trading market for our common stock.

***Voting control by our executive officers, directors, lenders and other affiliates may limit your ability to influence the outcome of director elections and other matters requiring stockholder approval.***

In connection with the closing of the financing transaction with Lion, Mr. Charney and Lion entered into a voting agreement, dated March 13, 2009 (the "Investment Voting Agreement"), and the Company and Lion entered into an investment agreement, dated March 13, 2009 (the "Investment Agreement"). Pursuant to the Investment Agreement, Lion has the right to designate up to two persons to our Board of Directors and a board observer (or, if our Company increases its board size to 12, Lion has the right to designate up to three persons to our Board of Directors and no board observers), subject to maintaining certain minimum ownership thresholds of, or shares issuable under, the warrant (the "Lion Warrant") issued on March 13, 2009, to Lion to purchase 16 million shares of Company common stock at an exercise price of \$2.00 per share, which exercise price is subject to adjustment under certain circumstances. Though no change to the existing Board of Directors composition is required under the Investment Agreement, we may consider changes in lieu of increasing the size of our Board of Directors. Two Lion designees were elected to our Board of Directors at our annual meeting of stockholders, which was held on October 28, 2009. The Investment Agreement also provides that for so long as Lion has the right to designate any person for nomination for election to our Board of Directors pursuant to the Investment Agreement, we will not increase the size of our Board of Directors to more than 10 directors (or 13 directors in the event we elect to increase the size of our Board of Directors to 12 directors as described above).

Pursuant to the Investment Voting Agreement, for so long as Lion has the right to designate any person or persons to the Board of Directors, Mr. Charney has agreed to vote his shares of common stock in favor of Lion's designees, provided that Mr. Charney's obligation to so vote terminates if he owns less than 6,000,000 shares of Company common stock (which number will be adjusted appropriately to take into account any stock split, reverse stock split or similar transaction). In addition, pursuant to the Investment Voting Agreement, for so long as Lion has the right to designate any person or persons to the Board of Directors, Lion has agreed to vote its shares of common stock in favor of Mr. Charney and, each other designee of Mr. Charney, provided that Lion's obligation to so vote terminates if either (i) Mr. Charney beneficially owns less than 27,900,000 shares of



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Company common stock (which number will be adjusted appropriately to take into account any stock split, reverse stock split or similar transaction) or (ii) (A) Mr. Charney is no longer employed on a full-time basis by our or any subsidiary of our and (B) Mr. Charney is in material breach of the non-competition and non-solicitation covenants contained in the Acquisition Agreement, as extended by a letter agreement, dated March 13, 2009, between Mr. Charney and Lion.

Accordingly, the parties to the Investment Agreement and the Investment Voting Agreement are able to control the election of directors. Mr. Charney beneficially owns approximately 52.8% of our outstanding common stock and voting power (such calculation does not give effect to dilution as a result of any exercise of the Lion Warrant or the warrant (the SOF Warrant ), issued on December 19, 2008, to SOF to purchase one million shares of our common stock at an exercise price of \$3.00 per share, which exercise price is subject to adjustment under certain circumstances). This concentration of ownership and the Investment Voting Agreement could have the effect of delaying or preventing a change in our control or discouraging a potential acquirer from attempting to obtain control of us, which in turn could have a material adverse effect on the market price of our common stock or prevent our stockholders from realizing a premium over the current market price for their shares of our common stock. Furthermore, Mr. Charney and Lion may also have interests that differ from yours and may vote their shares of our common stock in a way with which you disagree and which may be adverse to your interests.

***Significant fluctuations in exchange rates between the U.S. dollar and foreign currencies may adversely affect our revenues, operating income, net income and earnings per share, as well as future cash flows.***

We face exposure to adverse movements in foreign currency exchange rates as a result of our international operations. These exposures may change over time as business practices evolve, and they could have a material adverse impact on our financial results and cash flows. An increase in the value of the U.S. dollar relative to foreign currencies could make our products more expensive and therefore potentially less competitive in foreign markets. Conversely, lowering our price in local currency may result in lower U.S.-based revenue. A decrease in the value of the U.S. dollar relative to foreign currencies could increase the cost of local operating expenses. We utilize certain foreign currency forward exchange contracts to hedge our foreign currency exposure associated with certain assets and liabilities as well as anticipated foreign currency cash flows. These hedges are designed to reduce, but do not always entirely eliminate, the impact of currency exchange movements. Factors that could have an impact on the effectiveness of our hedging program include the accuracy of forecasts and the volatility of foreign currency markets as well as widening interest rate differentials and the volatility of the foreign exchange market. There can be no assurance that such hedging strategies will be successful and that currency exchange rate fluctuations will not have a material adverse effect on our operating results. In addition, while the hedges are designed to reduce volatility over the forward contract period, the contracts are not treated as hedges for accounting purposes, and therefore can create volatility in earnings during the period. The degree to which our financial results are affected for any given period will depend in part upon our hedging activities.

### **Item 1B. Unresolved Staff Comments**

None.

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**Item 2. Properties**

The following table sets forth the location and use of each of American Apparel's principal non-retail properties, which are all leased:

Los Angeles, California	Headquarters, Sewing, Cutting, and Distribution
Los Angeles, California	Knitting Facility
Los Angeles, California	Warehouse Facility
Hawthorne, California	Fabric Dyeing and Finishing Facility
South Gate, California	Cutting, Sewing, Garment Dyeing and Finishing Facility
Garden Grove, California	Cutting, Sewing, Knitting, Fabric Dyeing and Finishing Facility
Commerce, California	Warehouse Facility
Montreal, Quebec	Executive Offices, Distribution
Düsseldorf, Germany	Offices, Distribution
Neuss, Germany	Distribution
London, England	Offices
Tokyo, Japan	Offices
Seoul, South Korea	Offices

The lease on our headquarters facility in Los Angeles expired on December 31, 2008 and was renewed in July 2009. The current expiration date is July 31, 2019.

All of our retail stores are leased, well maintained and in good operating condition. Our retail stores are typically leased for a term of five to ten years with renewal options for an additional five to ten years. Most of these leases provide for base rent, as well as maintenance and common area charges, real estate taxes and certain other expenses. Selling space of opened stores will sometimes change due to store renovations that modify space utilization, use of staircases, the configuration of cash registers, and other factors. As well, a number of our store locations have undergone expansions in the past several years.

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The following tables set forth American Apparel's existing retail stores by geographic region, as of December 31, 2009:

**Domestic Locations (160)**

<i>Arizona (3)</i>	<i>California (cont. d.)</i>	<i>Louisiana (1)</i>	<i>New York (cont. d.)</i>	<i>Tennessee (2)</i>
Scottsdale	Studio City	New Orleans	Manhattan	Memphis
Tempe	Ventura		Chelsea	Nashville
Tucson		<i>Maryland (4)</i>	Columbia University	
	<i>Colorado (2)</i>	Annapolis	Columbus Circle	<i>Texas (8)</i>
<i>California (42)</i>	Boulder	Baltimore	FIT	Austin
Arcadia	Denver	Bethesda	Flatiron	Congress Ave
Berkeley (2)		Silver Spring	Gramercy Park	Guadalupe Street
Burlingame	<i>Connecticut (2)</i>		Harlem	Dallas
Camarillo	New Haven	<i>Massachusetts (4)</i>	Hell's Kitchen	Mockingbird NorthPark Center
Claremont	South Norwalk	Boston	Lower Broadway	Houston
Commerce		Back Bay	Lower East Side	Round Rock
Costa Mesa	<i>District of Columbia (2)</i>	Newbury Street	Noho	San Antonio
Gilroy	Georgetown	Cambridge	Soho	La Cantera
Los Angeles	Lincoln Square	Wrentham	Tribeca	North Star Mall
Cherokee			Upper East Side	
Echo Park	<i>Florida (12)</i>	<i>Michigan (3)</i>	Upper West Side	<i>Utah (1)</i>
Factory Store	Boca Raton	Ann Arbor	Riverhead	Salt Lake City
Hollywood	Coconut Grove	East Lansing	White Plains	
Little Tokyo	Gainesville	Royal Oak		
Los Feliz	Key West		<i>North Carolina (2)</i>	<i>Vermont (1)</i>
Melrose	Miami Beach	<i>Minnesota (2)</i>	Charlotte	Burlington
Robertson	Lincoln Road	Bloomington	Camden Road	
				<i>Virginia (1)</i>



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Westwood Village	Ocean Drive	Minneapolis	SouthPark Mall	Richmond
West Hollywood	Sunset Drive			
Huntington Beach	Washington	<i>Missouri (1)</i>	<i>Ohio (3)</i>	<i>Washington (4)</i>
La Jolla	Orlando	Kansas City	Cincinnati	Lynnwood
Malibu	St. Augustine		Cleveland	Seattle
Manhattan Beach	Sunrise	<i>Nebraska (1)</i>	Columbus	Capitol Hill
Napa	Wellington	Omaha		Downtown Seattle
Palo Alto			<i>Oregon (4)</i>	University Way
Pasadena	<i>Georgia (3)</i>	<i>Nevada (4)</i>	Eugene	
Rancho Cucamonga	Atlanta	Las Vegas	Portland	<i>Wisconsin (2)</i>
San Diego	Lenox Mall	Boca Park	Hawthorne Blvd.	Madison
Fashion Valley	Little Five Points	Caesars Palace	Stark Street	Milwaukee
Gaslamp	Savannah*	Miracle Mile	Tigard	
Hillcrest		Premium Outlets		
Pacific Beach	<i>Hawaii (2)</i>		<i>Pennsylvania (5)</i>	
San Francisco	Honolulu	<i>New Jersey (5)</i>	King of Prussia	
China Gate	Ala Moana	Cherry Hill	Philadelphia	
Haight Ashbury	Kalakaua Road	Edison	Sansom Common	
Union Street		Hoboken	Walnut Street	
Santa Ana	<i>Illinois (7)</i>	Paramus	Pittsburgh	
Santa Barbara	Chicago	Short Hills	Shadyside	
Santa Clara	Belmont & Clark		Univ. of Pittsburgh	
Santa Cruz	Gold Coast	<i>New York (24)</i>		
Santa Monica	Lincoln Park	Bleecker Street	<i>Rhode Island (1)</i>	
Main Street	Wicker Park	Brooklyn	Providence	
Third Street Promenade	Evanston	Carroll Gardens		
	Oak Brook	Court Street	<i>South Carolina (2)</i>	
	Schaumburg	Park Slope	Charleston	

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Williamsburg Columbia

Central Valley

Garden City

\* Closed in 2010

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**Canada (40)**

<i>Alberta (5)</i>	<i>British Columbia (8)</i>	<i>Ontario (13)</i>	<i>Quebec (11)</i>
Calgary	Burnaby	Kingston	Laval
17 <sup>th</sup> Avenue	Kelowna	London	Montreal
Market Mall	Vancouver	Ottawa	Cote-des-Neiges
Sunnyside-10 <sup>th</sup> Ave.	Granville	Rideau Centre	Cours Mont-Royal
Edmonton	Park Royal	Westboro	Mont-Royal Est
82 <sup>nd</sup> Avenue	Robson Street	Thornhill	St-Denis
West Edmonton Mall	South Granville	Toronto	Ste-Catherine West
	West 4th Street	Bloor Street	Ste-Catherine Est
	Victoria	College Street	Pointe-Claire
		Queen Street	Quebec
	<i>Manitoba (1)</i>	Sherway Gardens	Place Laurier
	Winnipeg	Yonge & Dundas	Rue St-Jean
		Yonge & Eglinton	Westmount
	<i>Nova Scotia (1)</i>	Yorkdale Shopping Centre	
	Halifax	Vaughan	<i>Saskatchewan (1)</i>
			Saskatoon

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**International Locations (81)**

***Europe (51)***

***Austria (1)***

Vienna

***Belgium (1)***

Antwerp

***France (10)***

Aix-en-Provence

Paris

Marais

Vielle du Temple

Beaurepaire

Avenue Victor Hugo

Saint-Germain

Saint-Honore (2)

Galleries Lafayette

Toulouse

***Italy (3)***

Florence

Milan

Rome

***Germany (14)***

Berlin

Alte Schönhauser Strasse

Bayreuther Strasse

Münzstrasse

Cologne

Dresden

Düsseldorf

Frankfurt

Hamburg

Jungfernstieg

Schanzenstrasse

Heidelberg

Mannheim

Munich

Schellingstrasse

Sendlinger Strasse

Stuttgart

***Spain (1)***

Barcelona

***Sweden (2)***

Stockholm

***Switzerland (2)***

Zurich

Josefstrasse

Rennweg

***United Kingdom (13)***

Brighton

Bristol

Glasgow

Liverpool

London

Camden High Street

Carnaby Street

Covent Garden

Kensington High Street

Oxford Street

Portobello Road

Shoreditch

Manchester

Nottingham

***Ireland (1)***

Dublin

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***Netherlands (3)***

Amsterdam

Westerstraat

Utrechtsestraat

Rotterdam

Götgatan

Kungsgatan

***Israel (2)***

Jerusalem

Tel Aviv

***Mexico (4)***

Mexico City

La Roma

Polanco

Monterrey

Playa del Carmen\*

***Brazil (1)***

São Paulo

***Australia (3)***

Adelaide

Melbourne

Sydney

***Asia (20)***

***China (3)***

Beijing

Nali Mall

World Trade Center

Shanghai

***Japan (9)***

Fukuoka

Osaka

Chayamachi

Shinsaibashi

Tokyo

Azabujuban

Daikanyama

Jiyugaoka

Shibuya (2)

Yokohama

***South Korea (8)***

Busan

Daegu

Seongnam

Seoul

Chungdam

Dae Hak Ro

Hong Dae

Kangnam

Myung-dong

\* Closed in 2010

**Store Pipeline**

As part of our new store expansion, at any one time we may have store locations under signed leases which are in the process of being opened. The store pipeline, as of March 31, 2010, included a location in Chicago, Illinois and a location in Leeds, United Kingdom. Through March 31, 2010, we have opened one location in Waterloo, Ontario.



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**Item 3. Legal Proceedings**

We are subject to various claims and contingencies in the ordinary course of our business, including those related to litigation, business transactions, employee-related matters and taxes, and others. When we are aware of a claim or potential claim, we assess the likelihood of any loss or exposure. If it is probable that a loss will result and the amount of the loss can be reasonably estimated, we will record a liability for the loss. While there can be no assurances, we do not expect that any of our pending legal proceedings will have any material financial impact on our results of operations, financial position or cash flows.

On or about September 19, 2005, Ms. Mary Nelson, an independent contractor in the sales department at American Apparel, commenced a suit in a case captioned as *Mary Nelson v. American Apparel, Inc., et al.*, Case Number BC333028, filed in Superior Court of the State of California for the County of Los Angeles, Central District, wherein she alleges she was wrongfully terminated, was subjected to harassment and discrimination based upon her gender and other claims related to her tenure at American Apparel. We deny all of Ms. Nelson's allegations of wrongdoing. Ms. Nelson is seeking unspecified monetary damages and costs. The trial has been stayed, and the Court of Appeal of the State of California has reversed the Superior Court's denial of our motion to compel arbitration pursuant to an agreement among the parties. On January 14, 2009, the California Supreme Court denied a petition filed by Ms. Nelson, requesting the California Supreme Court to review the California Appellate Court order compelling Ms. Nelson to arbitrate American Apparel's claims against her for breaches of a settlement agreement. Ms. Nelson has now exhausted all of her appeals. In May 2009, Ms. Nelson filed a Demand for Arbitration before JAMS (Judicial Arbitration and Mediation Services), whereby she asserts the following causes of actions: Breach of Agreement, Breach of Contract, Failure to Pay Settlement Monies, Fraud in the Inducement, and Disparagement. On August 28, 2009, we filed our answer and counterclaims for breach of contract against Ms. Nelson. The insurance carrier for our directors' and officers' insurance policy has asserted that it is not obligated to provide coverage for this proceeding. We intend to aggressively defend any allegations of wrongdoing.

On February 7, 2006, Sylvia Hsu, a former employee of American Apparel, filed a Charge of Discrimination with the Los Angeles District Office of the Equal Employment Opportunity Commission (EEOC) (*Hsu v. American Apparel: Charge No. 480- 2006-00418*), alleging that she was subjected to sexual harassment by a co-worker and constructively discharged as a result of the sexual harassment and hostile working environment. The EEOC's investigation of this charge is ongoing. On March 9, 2007, the EEOC expanded the scope of its investigation to other employees of American Apparel who may have been sexually harassed. In February 2008, the EEOC requested to speak with certain of our managers, supervisors and other employees in connection with its investigation. Approximately half of these interviews have been concluded, with the second half to be conducted at a future time to be determined. Given the broad scope of the EEOC's investigation, it is impossible to predict with any degree of accuracy how this matter will develop, how it will be resolved, what remedies or relief, if any, will be sought or what the impact might be on American Apparel. We intend to aggressively defend any allegations of wrongdoing.

On November 5, 2009, Guillermo Ruiz, a former employee of American Apparel, filed suit against us on behalf of putative classes of current and former non-exempt California employees (*Guillermo Ruiz, on behalf of himself and all others similarly situated v. American Apparel, Inc.*, Case Number BC425487) in the Superior Court of the State of California for the County of Los Angeles, alleging we failed to pay certain wages due for hours worked, to provide meal and rest periods or compensation in lieu thereof and to pay wages due upon termination to certain of our employees. The complaint further alleges that we failed to comply with certain itemized employee wage statement provisions and unfair competition law. The plaintiff is seeking compensatory damages and economic and/or special damages in an unspecified amount; premium pay, wages and penalties; injunctive relief and restitution; and reimbursement for attorneys' fees, interest and the costs of the suit. On December 22, 2009, the parties filed a written stipulation with the Court setting forth the parties' agreement to stay this matter for approximately six months, during which the parties will mediate Plaintiff's claims. In the event mediation is unsuccessful, the parties have agreed to submit this matter to binding arbitration. We do not

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have insurance coverage for this matter. Should the matter be decided against us, we could not only incur substantial liability but also experience an increase in similar suits and suffer reputational harm. We are unable to predict the financial outcome of this matter at this time, and any views we form as to the viability of this claim or the financial exposure in which it could result may change from time to time. No assurance can be made that this matter either individually or together with the potential for similar suits and reputational harm, will not result in a material financial exposure, which could have a material adverse effect upon our financial condition and results of operations.

We are currently engaged in several other employment-related claims and other matters incidental to our business. We believe that all such claims against us are without merit, and we intend to vigorously dispute the validity of the plaintiffs' claims. While the ultimate resolution of such claims cannot be determined, based on information at this time, we believe the amount, and ultimate liability, if any, with respect to these actions will not materially affect our business, financial position, results of operations, or cash flows. We cannot assure you, however, that such actions will not have a material adverse effect on our consolidated results of operations, financial position or cash flow.

**Item 4.      Reserved**



**Table of Contents****PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**  
**Market Information**

The principal market on which our common stock is traded is the NYSE Amex. Our common stock is traded under the symbol APP. Our units (the Endeavor Units) and warrants (the Endeavor Warrants), which were issued in the initial public offering of Endeavor Acquisition Corp., traded on the American Stock Exchange (now the NYSE Amex) under the symbols APP-U and APP-WS, respectively, until March 7, 2008, when all outstanding Endeavor Warrants were redeemed.

Each Endeavor Unit was comprised of one share of common stock and one Endeavor Warrant. Prior to the Acquisition, the Endeavor Units, common stock and Endeavor Warrants were traded on the American Stock Exchange (now the NYSE Amex) under the symbols EDA-U, EDA and EDA-WT, respectively. The Endeavor Units commenced trading on the NYSE Amex on December 16, 2005, and the common stock and Endeavor Warrants commenced trading on March 6, 2006.

The following table sets forth the range of high and low sales prices for the Endeavor Units, our common stock and the Endeavor Warrants for the periods indicated.

	Common Stock		Units		Warrants	
	High	Low	High	Low	High	Low
2008:						
Fourth Quarter	\$ 8.45	\$ 1.55	\$	\$	\$	\$
Third Quarter	10.05	5.48				
Second Quarter	9.97	5.90				
First Quarter (3/1/08 - 3/7/08)	14.45	8.50	17.78	17.78	6.00	5.90
2009:						
Fourth Quarter	\$ 3.55	\$ 2.42				
Third Quarter	4.20	2.80				
Second Quarter	6.97	2.66				
First Quarter	3.70	1.20				

**Holders**

On March 30, there were 1,385 recordholders and approximately 10,006 beneficial holders of our common stock.

**Dividends**

As a public company, we have not paid any cash dividends. Certain cash dividends and distributions were paid by Old American Apparel to its principal stockholders prior to becoming a public company. We intend to continue to retain earnings for use in the operation and expansion of our business and, therefore, do not anticipate paying any cash dividends in the foreseeable future. In addition, restrictions imposed by our debt instruments significantly restrict us from making dividends or distributions to shareholders.

**Units, Common Shares and Warrants**

The Endeavor Warrants and common stock comprising the Endeavor Units became separately tradable on March 7, 2006. Each Endeavor Warrant entitled the holder to purchase from American Apparel one share of American Apparel common stock at an exercise price of \$6.00. On February 6, 2008 we called for redemption, and on March 7, 2008 redeemed all of our issued and outstanding Endeavor Warrants. Prior to the redemption date of March 7, 2008, 16,153 of the 16,165 Endeavor Warrants outstanding at December 31, 2007 were

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exercised. The remaining 12 Endeavor Warrants were redeemed by us at a price of \$.01 per Warrant. As a result, the Endeavor Units and the Endeavor Warrants ceased to be outstanding and ceased to be registered, pursuant to Section 12(b) on March 7, 2008.

On December 19, 2008, in connection with an extension of the SOF Credit Agreement, we issued the SOF Warrants. On March 13, 2009, in connection with the Lion financing, we issued the Lion Warrants. The warrants were issued to SOF and Lion in private placements exempt from registration pursuant to Section 4(2) of the Securities Act of 1933, as amended.

The SOF Credit Agreement provided that if we failed to raise \$16 million of financing by March 13, 2009, we would be required to issue to SOF an additional warrant to purchase two million shares of Company common stock at an exercise price of \$2.00 per share and on other terms substantially identical to the terms of the SOF warrant issued to SOF in December 2008 in connection with the extension of the SOF Credit Agreement. As a result of the repayment in full of the SOF Credit Agreement with the proceeds of the loans under the Lion Credit Agreement, we were not required to issue to SOF the additional warrant.

For further discussion, including of proceeds received from exercise of warrants see Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources .

**Stock Price Performance Graph**

The graph below compares the cumulative total return of our common stock from March 7, 2006 through December 31, 2009 with the cumulative total return of companies comprising the Dow Jones Industrial Average, the S&P Retail Index, and the S&P500. The graph plots the growth in value of an initial investment of \$100 in each of our common stock, the Dow Jones Industrial Average, the S&P Retail Index, and the S&P500 over the indicated time periods, assuming reinvestment of all dividends, if any, paid on the securities. We have not paid any cash dividends and, therefore, the cumulative total return calculation for us is based solely upon stock price appreciation and not upon reinvestment of cash dividends. The stock price performance shown on the graph is not necessarily indicative of future price performance.

Dates	American Apparel	S&P Retail	S&P 500	Dow
March 7, 2006	100.00	100.00	100.00	100.00
December 29, 2006	126.76	107.30	110.96	113.73
December 31, 2007	206.90	88.11	114.87	121.04
December 31, 2008	27.45	60.02	70.66	80.09
December 31, 2009	42.76	88.37	87.24	95.16

**Table of Contents****Item 6. Selected Financial Data**

The selected historical financial data presented below under the heading **Selected Statement of Operations Data** and **Per Share Data** for the years ended December 31, 2009, 2008 and 2007 and the selected historical financial data presented below under the heading **Balance Sheet Data** as of December 31, 2009 and 2008 have been derived from, and are qualified by reference to, the audited consolidated financial statements included elsewhere in this Annual Report on Form 10-K. The selected historical financial data presented below under the heading **Selected Statement of Operations Data** and **Per Share Data** for the years ended December 31, 2006 and 2005 and the selected historical financial data presented below under the heading **Balance Sheet Data** as of December 31, 2007, 2006 and 2005 have been derived from, and are qualified by reference to, our audited consolidated financial statements which are not included in this Annual Report on Form 10-K.

On December 21, 2005, Endeavor Acquisition Corp. consummated its initial public offering, and on December 18, 2006, entered into an Agreement and Plan of Reorganization, amended November 7, 2007, with American Apparel, Inc., a California corporation ( **Old American Apparel** ), and its affiliated companies. Endeavor Acquisition Corp. consummated the acquisition of Old American Apparel and its affiliated companies on December 12, 2007 (the **Acquisition** ) and changed its name to American Apparel, Inc. The Acquisition was accounted for as a reverse merger ( **Merger** ) and recapitalization for financial reporting purposes. Accordingly, for accounting and financial purposes, Endeavor Acquisition Corp. was treated as the acquired company, and Old American Apparel was treated as the acquiring company. Accordingly, the historical financial information for periods and dates prior to December 12, 2007, is that of Old American Apparel, and its affiliated companies.

The data set forth below should be read in conjunction with **Management's Discussion and Analysis of Financial Condition and Results of Operations** and our Consolidated Financial Statements and notes included elsewhere in this Annual Report on Form 10-K.

	2009	Year Ended December 31, 2008 2007 2006 (In Thousands Except Per Share Data)			2005
<b>Selected Statement of Operations Data:</b>					
Net sales	\$ 558,775	\$ 545,050	\$ 387,044	\$ 284,966	\$ 201,450
Gross profit (5)	\$ 319,912	\$ 294,421	\$ 213,368	\$ 145,636	\$ 101,688
Income from Operations	\$ 24,415	\$ 36,064	\$ 31,122	\$ 10,572	\$ 10,782
Net Income (Loss)	\$ 1,112	\$ 14,112	\$ 15,478	\$ (1,606)	\$ 3,487
Pro forma Net Income conversion to C Corporation for tax purposes (unaudited) (3)	n/a	n/a	\$ 9,457	\$ 257	\$ 3,121
Cash Distributions/Dividends Paid (1)	\$	\$	\$ 22,147	\$ 696	\$ 1,793
<b>Per Share Data (2)</b>					
Net Earnings (Loss) per share basic	\$ 0.02	\$ 0.20	\$ 0.32	\$ (0.03)	\$ 0.07
Net Earnings (Loss) per share diluted	\$ 0.01	\$ 0.20	\$ 0.31	\$ (0.03)	\$ 0.07
Pro forma Net Earnings per share conversion to C Corporation for tax purposes (unaudited) basic (3)	n/a	n/a	\$ 0.19	\$ 0.01	\$ 0.06
Pro forma Net Earnings per share conversion to C Corporation for tax (unaudited) purposes diluted (3)	n/a	n/a	\$ 0.19	\$ 0.01	\$ 0.06
Weighted average number of shares basic	71,026	69,490	48,890	48,390	48,390
Weighted average number of shares diluted	76,864	70,317	49,414	48,390	48,390
Dividends Paid (1)	\$ 0.00	\$ 0.00	\$ 0.45	\$ 0.01	\$ 0.04
<b>Balance Sheet Data (4)</b>					
Total Assets (5)	\$ 327,579	\$ 333,609	\$ 233,350	\$ 163,056	\$ 124,226
Working Capital (5)	\$ 121,423	\$ 83,069	\$ 2,120	\$ 38,559	\$ 40,880
Total Long Term Debt Less Current Maturities	\$ 71,372	\$ 72,328	\$ 10,744	\$ 75,546	\$ 65,365
Stockholders' Equity	\$ 157,341	\$ 136,412	\$ 61,821	\$ 12,973	\$ 14,918

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- (1) Dividends paid represent cash dividends paid by Old American Apparel to its stockholders prior to becoming a public company. We do not anticipate paying any cash dividends in the foreseeable future.
- (2) The effect of the Merger has been given retroactive application in the earnings per share ( EPS ) calculation. The common stock issued and outstanding with respect to the pre-Merger stockholders of American Apparel, Inc. has been included in the EPS calculation since the Closing date of the Merger. All of American Apparel, Inc. s outstanding warrants (the Endeavor Warrants ) which were issued in the initial public offering of Endeavor Acquisition Corp. and underwriter s purchase option are reflected in the diluted EPS calculation, using the treasury stock method, commencing with the Closing date of the Merger.
- (3) As a result of the Merger, Old American Apparel was required to convert from a Subchapter S Corporation to a C Corporation as of the Closing on December 12, 2007. As a Subchapter S Corporation, U.S. federal and certain state income taxes were the responsibility of the entity s stockholders. Accordingly, the income taxes were not reflected in the entity s financial statements. The result of this conversion was to recognize deferred tax assets and liabilities from the expected tax consequences of temporary differences between the book and tax basis of the entity s assets and liabilities at the date of conversion into a taxable entity. This resulted in a deferred tax benefit of \$6,205 being recognized and included in the 2007 tax (benefit).

The unaudited pro forma computation of income tax included in the Consolidated Statements of Operations presented elsewhere in this Form 10-K, represents the tax effects that would have been reported had Old American Apparel been subject to U.S. federal and state income taxes as a corporation for the year ended December 31, 2007. Pro forma taxes are based upon the statutory income tax rates and adjustments to income for estimated permanent differences occurring during each period. Actual rates and expenses could have differed had Old American Apparel actually been subject to U.S. federal and state income taxes for all periods presented. Therefore, the unaudited pro forma amounts for net earnings per share are for informational purposes only and are intended to be indicative of the results of operations had Old American Apparel been subject to U.S. federal and state income taxes as a corporation for the year ended December 31, 2007.

- (4) Dov Charney, a 50% owner of Old American Apparel s common stock and 100% owner of American Apparel Canada Wholesale, Inc. and American Apparel Canada Retail, Inc. s (collectively, the CI Companies ) common stock and current Chief Executive Office of the Company received from American Apparel, Inc. 37,258 shares of its common stock in exchange for his ownership interest in Old American Apparel and CI Companies. The other 50% owner of Old American Apparel s Common Stock, Sang Ho Lim, received \$67,903 for his ownership interest, the equivalent of 11,132 shares of common stock.

Immediately prior to the closing of the Merger, American Apparel, Inc. had 19,933 shares of Common stock outstanding with a net tangible book value of \$121,589, net of \$5,494 of transaction costs. The net tangible book value consisted of cash of \$123,000, a tax liability of \$1,406 and accrued expenses of \$5. The net cash proceeds were used as follows: \$67,903 was paid to Sang Ho Lim, \$15,764 was paid to Dov Charney and Sang Ho Lim as a Company distribution to settle their estimated personal income tax liabilities as a result of Old American Apparel s subchapter S Corporation status, \$13,323 was used to repay related party and third party debt, and \$26,010 was available for working capital.

- (5) Certain amounts have been reclassified in fiscal 2008 and 2007 as disclosed in Note 3, Classification and Adjustments, in the Notes to the consolidated financial statements included elsewhere in this Form 10-K.

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

You should read the following discussion together with Part II, Item 6 Selected Financial Data and our audited consolidated financial statements and the related notes thereto included in Item 8 Financial Statements and Supplementary Data. In addition to historical consolidated financial information, this discussion contains forward-looking statements that reflect our plans, estimates and beliefs. Actual results could differ from these expectations as a result of factors including those described under Item 1A, Risk Factors, Special Note Regarding Forward-Looking Statements and elsewhere in this Annual Report on Form 10-K.

**Overview**

We are a vertically-integrated manufacturer, distributor, and retailer of branded fashion basic apparel. We design, manufacture and sell clothing for women, men, children and pets through retail, wholesale and online distribution channels. As of December 31, 2009, we operated 281 retail stores in 20 countries. Our wholesale business is a leading supplier of T-shirts and other casual wear to screen printers and distributors. We also operate an online retail e-commerce website at [www.americanapparel.com](http://www.americanapparel.com) where we sell our clothing directly to consumers.

We conduct our primary manufacturing operations out of an 800,000 square foot facility in the warehouse district of downtown Los Angeles, California. The facility houses our executive offices, as well as cutting, sewing, warehousing, and distribution operations. We conduct knitting operations in Los Angeles and Garden Grove, California, which produce a majority of the fabric we use in our products. We also operate dye houses that currently provide dyeing and finishing services for nearly all of the raw fabric used in production. We operate a dyeing and finishing facility in Hawthorne, California, which provides fabric dyeing and finishing services. We operate a garment dyeing and finishing facility, acquired in December 2007 and located in South Gate, California, which is used in cutting, sewing, dyeing and finishing garments. We operate a fabric dyeing and finishing facility, acquired in May 2008 and located in Garden Grove, California, which has been expanded to including knitting and cutting and sewing operations. Because we manufacture domestically and are vertically integrated, we believe this enables us to more quickly respond to customer demand and to changing fashion trends and to closely monitor product quality. Our products are noted for their quality and fit, and together with our distinctive branding these attributes have differentiated our products in the marketplace.

We report the following four operating segments: U.S. Wholesale, U.S. Retail, Canada, and International. We believe this method of segment reporting reflects both the way our business segments are managed and the way the performance of each segment is evaluated. The U.S. Wholesale segment consists of our wholesale operations and our online consumer operations in the U.S. The U.S. Retail segment consists of our retail store operations in the United States, which were comprised of 160 retail stores as of December 31, 2009. The Canada segment consists of our retail, wholesale and online consumer operations in Canada. As of December 31, 2009, the retail operations in the Canada segment were comprised of 40 retail stores. The International segment consists of our retail, wholesale and online consumer operations outside of the United States and Canada. As of December 31, 2009, the retail operations in the International segment were comprised of 81 retail stores in the following 18 countries: the United Kingdom, Ireland, Austria, Belgium, France, Germany, Italy, the Netherlands, Spain, Sweden, Switzerland, Israel, Australia, Brazil, Mexico, Japan, South Korea, and China.

The results of the respective business segments exclude unallocated corporate expenses, which consist of our shared overhead costs. These costs are presented separately and generally include, among other things, corporate costs such as human resources, legal, finance, information technology, accounting, and executive compensation.

During the period from January 1, 2007 through December 31, 2009, we increased the number of retail stores in the U.S. Retail segment from 93 to 160, increased the number of retail stores in the Canada segment from 26 to 40 and increased the number of retail stores in the International segment from 28 to 81. The following table details, by segment, the growth in retail store count during the years ended December 31, 2009, 2008 and 2007

**Table of Contents****Stores Opened by Year**

	United States	Canada	International	Total
Stores open as of December 31, 2006	93	26	28	147
<b>2007</b>				
Opened	13	5	20	38
Closed	(1)	(1)	(1)	(3)
Stores open as of December 31, 2007	105	30	47	182
<b>2008</b>				
Opened	44	8	29	81
Closed	(1)	(1)	(1)	(3)
Stores open as of December 31, 2008	148	37	75	260
<b>2009</b>				
Opened	15	5	8	28
Closed	(3)	(2)	(2)	(7)
Stores open of December 31, 2009	160	40	81	281

**Comparable Store Sales**

The table below shows the (decrease) increase in comparable store sales for our retail stores, by quarter for the years ended December 31, 2009, 2008 and 2007, including the number of retail stores included in the comparison at the end of each period.

	For the Quarter Ended				
	March 31	June 30	September 30	December 31	Full year
2009	(7%)	(10%)	(16%)	(7%)	(10%)
Number of Stores	169	175	200	235	
2008	36%	23%	24%	11%	22%
Number of Stores	140	145	150	162	
2007	17%	24%	27%	40%	29%
Number of Stores	104	119	131	138	

**Executive Summary**

For the year ended December 31, 2009, we reported net sales of \$558.8 million, an increase of \$13.8 million, or 2.5%, over the \$545.1 million reported for the year ended December 31, 2008. Gross margin increased to 57.3% for the year ended December 31, 2009 compared to 54.0% for the year ended December 31, 2008. The increase in gross margin was due to a favorable shift in mix from wholesale towards retail sales, as retail sales generate a higher gross margin. This increase was partially offset due to an increase in inventory costs caused by a reduction in labor efficiency in the second half of 2009 and a continued shift in production mix towards more complex retail styles. Operating expenses increased \$37.1 million, or 14.4%, to \$295.5 million for the year ended December 31, 2009 as compared to \$258.4 million for the year ended December 31, 2008. Interest expense increased \$8.7 million to \$22.6 million for the year ended December 31, 2009, as compared to \$13.9 million for the year ended December 31, 2008. Net income for the year ended December 31, 2009 decreased to \$1.1 million compared to \$14.1 million for the year ended December 31, 2008.

On December 30, 2009, our Canadian company replaced its secure revolving credit facility of C\$4.0 million with an increased revolving credit facility of C\$11.0 million from Bank of Montreal. As of December 31, 2009, C\$8.5 million was available on the facility.



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During April 2009, we successfully completed the second phase of the implementation of our Enterprise Resources Planning ( ERP ) system, which included the system conversions for our sales and distribution operations and financial accounting and reporting for the U.S. Wholesale segment. Previously, in April 2008, we successfully completed the first phase of the implementation of the ERP system, which included the conversion of our systems for manufacturing and warehouse operations, inventory management and control, and wholesale operations. We expect that the modules in the second phase of the implementation of the ERP system will enable us to better manage our distribution activities and wholesale financial reporting and further improve our ability to manage inventory levels.

On March 13, 2009, we entered into a private financing agreement with Lion Capital LLP ( Lion ) for \$80.0 million in secured second lien notes with a maturity of December 31, 2013 and detachable warrants. The majority of the financing proceeds were used to retire the existing second lien credit facility with SOF Investment, L.P. Private IV ( SOF ). The remainder of the proceeds was used to reduce the outstanding balance under our U.S. revolving credit facility, repay a portion of a related-party note, pay fees and expenses related to the financing, and for general working capital.

**Results of Operations****Year Ended December 31, 2009 compared to Year Ended December 31, 2008**

(Dollars in Thousands)

	2009		2008	
	Amount	% of Net Sales	Amount	% of Net Sales
Net sales	\$ 558,775	100.0%	\$ 545,050	100.0%
Cost of sales	238,863	42.7%	250,629	46.0%
Gross profit	319,912	57.3%	294,421	54.0%
Operating expenses	295,497	52.9%	258,357	47.4%
Income from operations	24,415	4.4%	36,064	6.6%
Interest expense	22,627	4.0%	13,921	2.6%
Foreign currency transaction (gain) loss	(2,920)	(0.5%)	621	0.1%
Other (income) expense	(220)	0.0%	155	0.0%
Income before income taxes	4,928	0.9%	21,367	3.9%
Income tax provision	3,816	0.7%	7,255	1.3%
Net income	\$ 1,112	0.2%	\$ 14,112	2.6%

**Net sales:**

The following table sets forth our net sales by business segment for the year ended December 31, 2009 as compared to the year ended December 31, 2008 (dollars in thousands):

	2009		2008		Change	% Change
	Amount	% of Net Sales	Amount	% of Net Sales		
U.S. Wholesale	\$ 141,521	25.3%	\$ 162,668	29.8%	\$ (21,147)	(13.0%)
U.S. Retail	191,325	34.2%	168,653	31.0%	22,672	13.4%
Canada	68,983	12.3%	67,280	12.3%	1,703	2.5%
International	156,946	28.2%	146,449	26.9%	10,497	7.2%



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Total net sales	\$ 558,775	100.0%	\$ 545,050	100.0%	\$ 13,725	2.5%
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Net sales increased \$13.7 million, or 2.5%, to \$558.8 million for the year ended December 31, 2009 as compared with \$545.1 million for the year ended December 31, 2008. The increase in net sales was primarily driven by 21 new retail stores opened through our U.S., Canadian and International retail operations net of seven store closures. This increase was partially offset by a decline in net sales from our U.S Wholesale segment, and the wholesale operations of our Canada and International segments. Additionally, our net sales results were negatively impacted as a result of the U.S. dollar appreciating against the local currencies of our international retail stores. On a constant currency basis, net sales would have been \$16.7 million greater than reported for the year ended December 31, 2009.

**U.S. Wholesale:** Total net sales for our U.S. Wholesale segment decreased \$21.1 million, or 13.0%, to \$141.5 million for the year ended December 31, 2009 as compared to \$162.7 million for the year ended December 31, 2008. Net sales to wholesale customers (excluding online consumer sales) decreased \$18.9 million, or 13.8%, to \$118.2 million for the year ended December 31, 2009 as compared to \$137.2 million for the year ended December 31, 2008. This decrease was primarily caused by difficult economic conditions for our wholesale customers, especially for private label and manufacturer customers, who significantly reduced their order volumes. Online consumer sales decreased \$2.2 million, or 8.6%, to \$23.3 million for the year ended December 31, 2009, as compared to \$25.5 million for the year ended December 31, 2008. The decrease in online consumer sales was primarily due to a significant reduction in online advertising and the cannibalization of online sales as a result of operating additional retail locations.

**U.S. Retail:** Net sales for the U.S. Retail segment increased \$22.7 million, or 13.4%, to \$191.3 million for the year ended December 31, 2009 as compared to \$168.7 million for the year ended December 31, 2008. The increase was primarily caused by \$14.5 million of incremental net sales contributed by the 15 new retail stores opened in key markets within the U.S. during 2009. The increase was partially offset by a \$24.8 million, or 16%, decline in net sales from same store sales for the year ended December 31, 2009. Since December 31, 2008 we opened 15 new retail stores, while closing three and the number of stores in operation increased from 148 to 160.

**Canada:** Total net sales for our Canada segment increased \$1.7 million, or 2.5%, to \$69.0 million for the year ended December 31, 2009 as compared to \$67.3 million for the year ended December 31, 2008. Net sales to retail customers increased \$3.1 million, or 5.9% to \$56.0 million for the year ended December 31, 2009 compared to \$52.9 million for the year ended December 31, 2008. The increase was primarily caused by \$3.3 million of incremental net sales contributed by the five new retail stores opened in key markets within Canada during 2009. The increase was partially offset by a \$2.4 million, or 5%, decline in same store sales for the year ended December 31, 2009. Since December 31, 2008 we opened 5 new retail stores, while closing two and the number of stores in operation increased from 37 to 40.

Net sales to wholesale customers decreased \$1.3 million, or 10% to \$11.4 million for the year ended December 31, 2009 as compared to \$12.7 million for the year ended December 31, 2008. This decrease was primarily caused by difficult economic conditions for our wholesale customers, especially for private label and manufacturer customers, who significantly reduced their order volumes. Online sales decreased \$0.1 million, or 7.6%, to \$1.6 million for the year ended December 31, 2009 as compared to \$1.7 million for the year ended December 31, 2008.

Additionally, the value of a U.S. dollar against the Canadian dollar increased during the year ended December 31, 2009 resulting in a \$4.9 million decline in net sales on a constant currency basis.

**International:** Total net sales for the International segment increased \$10.5 million, or 7.2%, to \$156.9 million for the year ended December 31, 2009 as compared to \$146.4 million for the year ended December 31, 2008. Net sales to retail customers increased \$12.3 million, or 10.3% to \$132.1 million for the year ended December 31, 2009 as compared to \$119.7 million for the year ended December 31, 2008. The increase was primarily caused by \$6.0 million of incremental net sales contributed by the eight new retail stores opened in key markets during 2009. The increase was partially offset by a 4% decline in same store sales for the year ended

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December 31, 2009. Since December 31, 2008, we opened 8 new retail stores, while closing two and the number of stores in operation increased from 75 to 81.

Net sales to wholesale customers decreased \$2.1 million, or 14.8%, to \$12.4 for the year ended December 31, 2009 as compared to \$14.5 million for the year ended December 31, 2008. This decrease was primarily caused by difficult economic conditions for our wholesale customers, especially for private label and manufacturer customers, who significantly reduced their order volumes. Online net sales increased \$0.3 million, or 2.4% to \$12.5 million for the year ended December 31, 2009 as compared to \$12.2 million for the year ended December 31, 2008.

Additionally, the value of a U.S. dollar against the local currencies of our international retail stores increased during the period resulting in an \$11.8 million decline in net sales on a constant currency basis

**Cost of sales:** Cost of sales as a percentage of net sales was 42.7% and 46.0% for the years ended December 31, 2009 and 2008, respectively. Cost of sales for 2008 was impacted by \$13.2 million, or 2.4%, as a percentage of sales, in stock based compensation expense relating to the award of approximately 1.9 million shares of common stock to our manufacturing employees (the 2008 Grant ) during the third quarter of 2008. On a comparative basis, excluding the impact of the 2008 Grant, our cost of sales as a percentage of net sales decreased from 43.6% for the year ended December 31, 2008 to 42.7% for the year ended December 31, 2009. Cost of sales was impacted by a shift in mix from wholesale to retail sales, as retail increased from 62.6% of total net sales in 2008 to 67.9% of total net sales in 2009. The favorable impact from the shift in mix was partially offset by the negative impact of the appreciation of the U.S. dollar versus foreign currencies for the full year 2009 relative to the full year 2008. Additionally, cost of sales was also negatively impacted by lower capacity utilization of our manufacturing facilities in the first half of 2009, and the substantial reduction in manufacturing efficiency experienced in the fourth quarter of 2009 at our production facilities.

**Gross profit:** Gross margin for 2009 was 57.3% as compared to 54.0%, or 56.4% excluding the impact of the 2008 Grant, in 2008. The increase in gross margin was due to a favorable shift in mix from wholesale towards retail sales, as retail sales generate a higher gross margin. This increase was partially offset due to an increase in inventory costs caused by a reduction in labor efficiency in the second half of 2009 and a continued shift in production mix towards more complex retail styles. We expect that the effects of lower production efficiency will continue into 2010.

**Operating expenses:** The following table sets forth our operating expenses for the year ended December 31, 2009 as compared to December 31, 2008 (dollars in thousands):

	2009		2008		Change	% Change
	Amount	% of Net Sales	Amount	% of Net Sales		
Selling	\$ 183,113	32.8%	\$ 168,516	30.9%	\$ 14,597	8.7%
Warehouse and distribution	15,405	2.8%	15,606	2.9%	(201)	(1.3%)
General and administrative	96,979	17.3%	74,235	13.6%	22,744	30.6%
Total operating expenses	\$ 295,497	52.9%	\$ 258,357	47.4%	\$ 37,140	14.4%

**Operating expenses:** Operating expenses increased \$37.1 million, or 14.4%, to \$295.5 million for the year ended December 31, 2009 as compared to \$258.4 million for the year ended December 31, 2008. The increase in operating expenses was primarily caused by increased occupancy, payroll, and depreciation expenses incurred as a result of operating an additional 21 net stores at the end of 2009 compared to the end of 2008, as well as due to the full year impact of increased operating expenses from the additional 78 net new stores opened in 2008. Operating expenses were also higher in 2009 due to \$3.3 million in non-cash retail store impairment charges recorded in 2009 compared to \$0.6 million in 2008. Pre-opening expenses for retail stores were \$2.4 million in 2009 versus \$10.3 million in 2008.

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**Selling expenses:** Selling expenses together with unallocated corporate selling, advertising and promotion expenses, for the year ended December 31, 2009, increased \$14.6 million, or 8.7%, to \$183.1 for the year ended December 31, 2009 as compared to \$168.5 for the year ended December 31, 2008. Specifically, rent and occupancy costs increased \$18.3 million and payroll and benefit costs increased \$5.5 million. The increase in payroll costs was a result of higher staffing costs required to support the increased number of stores in operation compared to in the prior year.

Increases in rent and occupancy costs and payroll and benefit costs were partially offset by decreases in advertising, trade show and catalog expenses. Advertising, trade show and catalog costs included in selling expenses for the year ended December 31, 2009 were \$15.4 million, or 2.8% of net sales, as compared with \$25.0 million, or 4.5% of net sales, for the year ended December 31, 2008. The decrease of \$9.6 million was mainly due to a reduction in discretionary expenses to promote new store openings and to promote our products through print publications, magazines, trade shows, catalogs and online media.

Pre-opening expenses for the U.S. Retail segment totaled \$2.3 million for the year ended December 31, 2009, associated with the opening of 15 new retail stores, as compared with \$5.8 million for the year ended December 31, 2008. Pre-opening expenses in the Canada and International segments totaled \$1.6 million for the year ended December 31, 2009, associated with the opening of 13 new retail stores, as compared with \$4.5 million for the year ended December 31, 2008. Pre-opening expenses include costs related to opening new stores such as materials, pre-opening labor and training; utilities, travel, and IT labor costs. The decrease in pre-opening expenses from the prior year was due to the larger number of stores in the process of being opened in prior year.

**Warehouse and distribution expenses:** Warehouse and distribution expenses decreased \$0.2 million, or 1.3%, to \$15.4 million for the year ended December 31, 2009 as compared to \$15.6 million for the year ended December 31, 2008. These expenses represented 2.8% and 2.9% of the total net sales for the years ended December 31, 2009 and 2008, respectively. The warehouse and distribution expense was consistent with prior year.

**General and administrative expenses:** General and administrative ( G&A ) expenses increased \$22.7 million, or 30.6%, to \$97.0 million for the year ended December 31, 2009, as compared to \$74.2 million for the year ended December 31, 2008. G&A expenses represented 17.4% and 13.6% of total net sales for the years ended December 31, 2009 and 2008, respectively. G&A expenses increased by \$7.5 million due to higher depreciation charges, and \$4.1 million due to an increase in salaries, wages and benefits, primarily associated with an increased number of retail stores in operation during the year ended December 31, 2009 as compared to year ended December 31, 2008. An additional \$5.1 million of the increase in G&A was due to higher professional fees related to accounting and legal services, \$1.6 million related to bonuses and director stock grants and an increase of \$3.0 million in fixed asset impairment charges related to underperforming retail stores scheduled for closure.

**Interest expense:** The major components of interest expense for the year ended December 31, 2009 consisted of interest on our revolving line of credit, loans from our CEO and unrelated parties, capital leases and our term loans. Interest rates on our various debt facilities and capital leases ranged from 5.7% to 19.3% during the year ended December 31, 2009 and 6.2% to 26.0% during the year ended December 31, 2008. Interest expense increased \$8.7 million to \$22.6 million for the year ended December 31, 2009, as compared to \$13.9 million for the year ended December 31, 2008. Interest expense represented 4.0% and 2.6% of the total net sales for the years ended December 31, 2009 and 2008, respectively. The net increase in interest expense was primarily attributable to the amortization of debt discount, deferred financing costs and higher borrowings under the Lion Credit Agreement as compared to our previous second lien credit facility. Additionally, \$0.9 million of bank audit fees are included in interest expense for the year ended December 31, 2009, whereas no such fees were incurred in the prior year.

**Other (income) expense:** Other income was \$(3.1) million for the year ended December 31, 2009 as compared to other expense of \$0.8 million for the year ended December 31, 2008. Other income represented

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(0.6%) of the total net sales for the year ended December 31, 2009 as compared to other expense which represented 0.1% of the total net sales for the year ended December 31, 2008. The large change from other expense in 2008 to other income primarily relates to \$2.9 million of foreign currency transaction gain.

Additionally, the value of a U.S. dollar against the Canadian dollar increased during the year ended December 31, 2009 resulting in a \$4.9 million decline in net sales on a constant currency basis.

**Income tax provision:** Income taxes decreased \$3.5 million to a \$3.8 million income tax provision for the year ended December 31, 2009, as compared to a \$7.3 million income tax provision for the year ended December 31, 2008. The decrease was due to the decline in income before taxes for the year ended December 31, 2009 as compared to the year ended December 31, 2008. The effective income tax rate for the year ended December 31, 2009 was 77.4% as compared to 34% for the year ended December 31, 2008. The significant increase in the effective income tax rate for the year ended December 31, 2009 compared to prior year was primarily due to the establishment of valuation allowances against certain foreign net operating losses and the establishment of certain liabilities related to uncertain tax positions raised in connection with certain income tax audits. We expect our effective income tax rate in 2010 to return to a percentage consistent with previous years.

We file income tax returns for various states and foreign jurisdictions. Where applicable, we provide for state and foreign taxes at the applicable statutory state and country rates multiplied by pre-tax income.

**Net income:** Our net income for the year ended December 31, 2009 decreased \$13.0 million to \$1.1 million compared to \$14.1 million for the year ended December 31, 2008 as a result of the various factors described above.

**Year Ended December 31, 2008 compared to Year Ended December 31, 2007****(Dollars in Thousands)**

	2008		2007	
	Amount	% of Net Sales	Amount	% of Net Sales
Net sales	\$ 545,050	100.0%	\$ 387,044	100.0%
Cost of sales	250,629	46.0%	173,676	44.9%
Gross profit	294,421	54.0%	213,368	55.1%
Operating expenses	258,357	47.4%	182,246	47.1%
Income from operations	36,064	6.6%	31,122	8.0%
Interest expense	13,921	2.6%	17,541	4.5%
Foreign currency transaction loss (gain)	621	0.1%	(722)	(0.2)%
Other expense (income)	155	0.0%	(980)	(0.3)%
Income before income taxes	21,367	3.9%	15,283	3.9%
Income tax provision (benefit)	7,255	1.3%	(195)	(0.1)%
Net income	\$ 14,112	2.6%	\$ 15,478	4.0%

Pro forma Computation Related to Conversion to C Corporation for income tax purposes (unaudited) for the year ended December 31, 2007 (dollars in thousands):

Historical income before taxes	\$ 15,283	3.9%
Pro forma provision for income taxes	5,826	1.5%

Pro forma net income	\$ 9,457	2.4%
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**Table of Contents****Net sales:**

The following table sets forth our net sales by business segment for the year ended December 31, 2008 as compared to the year ended December 31, 2007 (dollars in thousands):

	2008		2007		Change	% Change
	Amount	% of Net Sales	Amount	% of Net Sales		
U.S. Wholesale	\$ 162,668	29.8%	\$ 144,478	37.3%	\$ 18,190	12.6%
U.S. Retail	168,653	31.0%	115,615	29.9%	53,038	45.9%
Canada	67,280	12.3%	42,407	11.0%	24,873	58.7%
International	146,449	26.9%	84,544	21.8%	61,905	73.2%
<b>Total net sales</b>	<b>\$ 545,050</b>	<b>100.0%</b>	<b>\$ 387,044</b>	<b>100.0%</b>	<b>\$ 158,006</b>	<b>40.8%</b>

One significant factor contributing to the overall growth in net sales was the expansion of our international operations, as evidenced by the opening of 29 international retail stores with one store closing during the year ended December 31, 2008. In our Canada segment, during the year ended December 31, 2008, 8 retail stores were opened and one store was closed. Additionally, during the same period 44 retail stores were opened and one retail store was closed in our U.S. Retail business segment. Also of primary significance to the expansion of American Apparel retail business in the U.S. was our increased focus on building brand awareness and targeted advertising campaigns as further described below;

Net sales increased \$158.0 million, or 40.8%, from \$387.0 million for the year ended December 31, 2007 to \$545.0 million for the year ended December 31, 2008.

**U.S. Wholesale:** Net sales for our U.S. Wholesale segment increased \$18.2 million, or 12.6%, from \$144.5 million for the year ended December 31, 2007 to \$162.7 million for the year ended December 31, 2008. This increase was primarily due to an increase in online sales due to strategic advertising and increased brand awareness. Third party wholesale and online sales increased from \$125.8 million and \$18.7 million in 2007 to \$137.2 million and \$25.5 million in 2008, respectively. One of the primary drivers behind the increase in U.S. Wholesale sales was the ability to meet customer demands through increased stock of inventory on hand. During most of 2008, we continued to increase our production in order to meet customer demand during the peak sales season.

**U.S. Retail:** Net sales for our U.S. Retail segment increased \$53.0 million, or 45.9%, from \$115.6 million for the year ended December 31, 2007 to \$168.7 million for the year ended December 31, 2008. Growth was fueled by the addition of retail stores in key markets within the U.S. in 2008 which contributed incremental sales of \$30.4 million over the prior year, as well as a 20.7% increase of \$22.6 million in comparable store sales in 2008 compared to 2007. Same-store sales are calculated as the sales increase over the previous year for stores that have been open for more than twelve months. As of December 31, 2008, the number of open stores was 148, while as of December 31, 2007, the number of open stores was 105.

**Canada:** Net sales for our Canada segment increased \$24.9 million, or 58.7%, from \$42.4 million for the year ended December 31, 2007 to \$67.3 million for the year ended December 31, 2008. This was a result of the addition of retail stores in key markets within Canada which contributed incremental sales of \$13.8 million of the prior year, as well as a 37.7% increase of \$11.1 million in same store sales in 2008 compared to 2007. The number of open retail stores increased to 37 retail stores as of December 31, 2008 from 30 retail stores as of December 31, 2007. The increase in comparable store sales was primarily the result of increased brand awareness and higher sales volumes. Canada wholesale and online sales volume was consistent with the prior year.

**International:** Net sales for our International segment increased \$61.9 million, or 73.2%, from \$84.5 million for the year ended December 31, 2007 to \$146.4 million for the year ended December 31, 2008. This

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increase was primarily due to the net increase of 28 retail stores in the international segment which contributed incremental sales of \$61.9 million over the prior year, from 47 retail stores as of December 31, 2007 to 75 retail stores as of December 31, 2008. Comparable store sales in the International segment increased 18.3% or \$11.7 million for the year ended December 31, 2008 as compared to the year ended December 31, 2007. During 2008, we opened 29 new stores in Australia, Belgium, Brazil, China, France, Germany, Israel, Italy, Japan, Korea, Mexico, Netherlands, Spain, Switzerland and the United Kingdom. During the year ended December 31, 2008, approximately \$14.5 million and \$12.2 million of sales were generated by wholesale and online sales, respectively, compared with \$12.6 million and \$6.6 million for wholesale and online sales, respectively, for the year ended December 31, 2007.

**Cost of sales:** Cost of sales as a percentage of net sales was 46.0% and 44.9% for the years ended December 31, 2008 and 2007, respectively. The increase was primarily due to the recording \$12.1 million of share based compensation expense related to the stock award of approximately 1.9 million shares of common stock to manufacturing employees on August 14, 2008 and \$1.1 million of employer related payroll taxes related to the stock grant in cost of sales for the year ended December 31, 2008. The \$13.2 million of expenses related to the stock award increased our cost of sales as a percentage of net sales by 2.4%. Excluding the impact of the aforementioned expenses related to the stock award, our cost of sales as a percentage of net sales decreased from 44.3% for the year ended December 31, 2007 to 43.6% for the year ended December 31, 2008. This decrease in cost of sales as a percentage of net sales was primarily due to the change in the overall sales mix during the year ended December 31, 2008 which included a higher level of retail sales as a result of the expansion of the retail business in the U.S. Retail, Canada, and International segments which generate higher gross margins than the U.S. Wholesale segment.

To supplement our in-house production capacity in December 2007, we acquired a new garment dyeing and finishing facility in South Gate, California, which began operations in 2008. The new dyeing and finishing facility is capable of dyeing completely sewn garments and the purchase of these assets added garment dyeing capability to our production process. The new facility began production in January 2008 and will further enhance our capability for in-house quality control. This acquisition included the assumption of the lease for the facility as well as the purchase of all of the tangible personal property at the plant. Startup expenses typically associated with manufacturing at new facilities resulted in approximately \$0.9 million of charges in cost of sales, attributable largely to the fact that, at this location, we began to manufacture certain denim based new styles which are more costly to manufacture. The \$0.9 million of additional cost of sales charges represents approximately 1.2% of the total increase in cost of sales.

To further supplement our in-house production capacity, in May 2008, we acquired an existing fabric dyeing and finishing facility in Garden Grove, California. In addition to providing substantial new dyeing capacity, the facility has available production space in which our added knitting capacity. The facility was formerly a contract dyeing vendor for our, and operations were not interrupted by the acquisition.

**Gross profit:** Gross profit percentage decreased from 55.1% of net sales for the year ended December 31, 2007 to 54.0% of net sales for the year ended December 31, 2008. Gross margin was negatively impacted by the \$13.2 million of expenses from the stock award to manufacturing employees, including related employer payroll taxes of \$1.1 million. The \$13.2 million of expenses decreased our gross margin by 2.4%. Excluding the impact of the aforementioned expenses related to the stock award, our gross margin for the year ended December 31, 2008 increased from 55.1% for the year ended December 31, 2007 to 56.4% for the year ended December 31, 2008. This increase in our gross margin was primarily due to an increase in the mix of sales coming from retail sales versus wholesale, along with an increase in online consumer sales. As the price of our products have remained relatively consistent in recent history, with no immediate plan to make changes, fluctuations in gross profit are primarily impacted by our sales mix and any production variances that are allocated to cost of sales. This benefit was partially offset by the hiring of a significant number of new manufacturing employees to support increased production.



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**Operating expenses:** The following table sets forth our operating expenses for the year ended December 31, 2008 as compared to December 31, 2007 (dollars in thousands).

	2008		2007		Change	% Change
	Amount	% of Net Sales	Amount	% of Net Sales		
Selling	\$ 168,516	30.9%	\$ 115,602	29.9%	\$ 52,914	45.8%
Warehouse and distribution	15,606	2.9%	10,663	2.8%	4,943	46.4%
General and administrative	74,235	13.6%	55,981	14.4%	18,254	32.6%
Total operating expenses	\$ 258,357	47.4%	\$ 182,246	47.1%	\$ 76,111	41.8%

**Operating expenses:** Operating expenses increased from \$182.2 million for the year ended December 31, 2007 to \$258.4 million for the year ended December 31, 2008, an increase of \$76.1 million or 41.8%. Operating expenses include:

**Selling expenses:** Selling expenses together with unallocated corporate selling, advertising and promotion expenses, for the year ended December 31, 2008, were \$168.5 million, which represented 30.9% of net sales, as compared to \$115.6 million for the year ended December 31, 2007, which represented 29.9% of net sales. Increases in selling expenses are due to the increase in worldwide retail store locations as well as the strategic promotional advertising of our products throughout all of its segments.

Advertising costs attributable as selling expenses for the year ended December 31, 2008 were \$18.4 million, representing 3.4% of net sales, compared with \$12.7 million, or 3.3% of net sales, for the year ended December 31, 2007. Advertising costs increased \$5.7 million mainly due to expenses incurred to promote new store openings and to promote our brand and products, primarily online, but also through print media.

The number of open stores increased from 182 as of December 31, 2007 to 260 as of December 31, 2008, resulting in an increase in rent and occupancy costs of \$19.4 million during the year ended December 31, 2008 compared to the prior year. Payroll costs increased from \$48.4 million for the year ended December 31, 2007 to \$69.3 million for the year ended December 31, 2008, for an increase of \$20.9 million. This increase in payroll costs was a result of increased staffing levels to support the increased number of stores and higher sales volumes at existing stores. We also increased compensation to certain valued employees, as we believe that we must provide competitive compensation opportunities to attract, motivate and retain qualified employees.

Costs related to preparing for opening new stores include materials, pre-opening labor and training, utilities, travel, rent and IT labor and costs. Pre-opening costs for the U.S. Retail segment were \$5.8 million for the year ended December 31, 2008 compared to \$1.3 million for the year ended December 31, 2007. The Canadian segment had a total of \$0.5 million in pre-opening expenses for the year ended December 31, 2008 compared to no pre-opening expenses for the year ended December 31, 2007. There was a total of \$4.0 million in pre-opening expenses in the International segment for the year ended December 31, 2008 compared to \$3.9 million for the year ended December 31, 2007.

**Warehouse and distribution expenses:** Warehouse and distribution expenses for the year ended December 31, 2008 were \$15.6 million as compared to \$10.7 million for the year ended December 31, 2007, an increase of \$4.9 million or 46.4%. These expenses represented 2.9% and 2.8%, respectively, of the total net sales for the years ended December 31, 2008 and 2007. The increase in warehouse and distribution expense is attributable to increases of \$4.1 million in staffing expenses necessary to support increased volume and sales growth, primarily in the retail business.

**General and administrative expenses:** General and administrative expenses for the year ended December 31, 2008 were \$74.2 million, as compared to \$56.0 million for the year ended December 31, 2007, an increase of \$18.2 million or 32.6%. General and administrative expenses represented 13.6% and 14.5% of total net sales for the years ended December 31, 2008 and 2007, respectively.

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General and administrative expenses increased by approximately \$7.5 million due to an increase in corporate overhead and \$13.4 million due to growth in the administrative structure required to support the growth in our retail business in the U.S. Retail, Canada and International segments. The total number of retail stores increased from 182 opened stores at December 31, 2007 to 260 opened stores at December 31, 2008.

Corporate overhead expenses for the year ended December 31, 2008 increased to \$37.2 million, as compared to \$29.7 million for the year ended December 31, 2007, an increase of \$7.5 million. The increase in corporate overhead expenses was the result of additional expenses for higher salaries and payroll related expenses and professional fees due to increased staffing and the regulatory environment of operating as a public company in 2008. Of the \$7.5 million increase in corporate expenses, professional and consulting fees increased by \$5.8 million and the remaining \$1.7 million increase was primarily due to an increase in information technology and web development expenses. Professional and consulting fees were \$12.3 million and \$6.5 million for the years ended December 31, 2008 and 2007, respectively. The \$5.8 million increase in professional and consulting fees primarily related to an increase of \$2.5 million in accounting fees directly related to public company reporting and compliance requirements, \$1.9 million in legal fees and \$1.4 million in consulting fees related to review work required under the Sarbanes-Oxley Act of 2002 and other initiatives.

**Interest expense:** The major components of interest expense for the year ended December 31, 2008, consisted of interest on the outstanding revolving credit facility, loans from related and unrelated parties and the term loan facility with SOF. We used proceeds from the exercise of the warrants in the first quarter of 2008 to reduce the level of debt outstanding. The reduction in the level of debt resulted in a \$3.6 million decrease in interest expense from \$17.5 million for the year ended December 31, 2007 to \$13.9 million for the year ended December 31, 2008. Interest rates on debt ranged from 6% to 21% during the year ended December 31, 2008, compared to 4.6% to 24% for the year ended December 31, 2007. Interest expense represented 2.6% and 4.5% of the total net sales for the years ended December 31, 2008 and 2007, respectively. The net decrease in interest expense was also attributable to the decreased LIBOR rate in the year ended December 31, 2008. Interest expense also included approximately \$0.5 million of loan fees, relating to renegotiating the terms of our Credit Agreement.

**Other expense (income):** Other expense was \$0.2 million for the year ended December 31, 2008 as compared to other income of \$1.0 million for the year ended December 31, 2007. The increase in other (income) expense is attributable to tariff charges assessed and prior uncollected receivables. Other expense represented 0.0% of the total net sales for the year ended December 31, 2008 as compared to other income which represented (0.3%) of the total net sales for the year ended December 31, 2007.

**Income tax provision (benefit):** Income tax provision increased from \$0.2 million benefit for the year ended December 31, 2007 to \$7.3 million expense for the year ended December 31, 2008.

Prior to July 1, 2004, Old American Apparel operated as a C corporation under U.S. tax law. Effective July 1, 2004, the stockholders elected to be taxed under Subchapter S of the Internal Revenue Code (the S Corporation Election). During the period of the S Corporation Election, federal income taxes and certain state taxes were the responsibility of Old American Apparel's stockholders. The S Corporation Election terminated with the consummation of the Acquisition on December 12, 2007. As a result of the change of Old American Apparel's S corporation status for U.S. tax purposes to the C corporation status on December 12, 2007, the deferred tax assets and liabilities were adjusted to reflect the change in federal and state tax rates applicable to C corporations.

We file income tax returns for various states and foreign jurisdictions. Where applicable, we provide for state and foreign taxes at the applicable statutory state and country rates multiplied by pre-tax income.

**Net income:** Our net income for the year ended December 31, 2008 decreased by approximately \$1.4 million to \$14.1 million compared to \$15.5 million for the year ended December 31, 2007 as a result of the various factors described above.

**Table of Contents****Liquidity and Capital Resources**

Over the past years, our growth has been funded through a combination of borrowings from related and unrelated parties, bank debt and lease financing, and proceeds from the exercise of warrants. Our principal liquidity requirements are for working capital and capital expenditures. We fund our liquidity requirements primarily through cash on hand, cash flow from operations, if any, and borrowings from revolving credit facilities, related party notes from our CEO and term loans under the Lion Credit Agreement. We generate cash primarily through the sale of our products manufactured by us at our retail stores and through our wholesale operations. Primary uses of cash are for the purchase of raw materials, payment to our manufacturing employees and retail employees, retail store opening costs and the payment of rent for retail stores. We believe that cash on hand, future funds from operations and borrowing from revolving credit facilities will be sufficient to fund our cash requirements for the next twelve months. There is no assurance, however, that we will be able to generate sufficient cash flow or that we will be able to maintain our ability to borrow under our revolving credit facilities.

As of December 31, 2009, we had (i) approximately \$9.0 million in cash, (ii) \$41.2 million available and \$6.3 million outstanding under the BofA Credit Agreement, and (iii) \$65.6 million of borrowings outstanding under the Lion Credit Agreement, net of discount, and including accrued paid-in-kind interest of \$6.1 million. See [Debt Agreements](#) below for an overview of the BofA Credit Agreement, the Lion Credit Agreement and our other debt agreements.

Cash Flow Overview for the years ended December 31, 2009, 2008 and 2007 is as follows (dollars in thousands):

	2009	2008	2007
Net cash provided by (used in):			
Operating activities	\$ 45,203	\$ 18,886	\$ (6,496)
Investing activities	(20,889)	(69,865)	(22,737)
Financing activities	(25,471)	41,171	44,530
Effect of foreign exchange rate changes on cash	(1,165)	1,884	215
Net (decrease) increase in cash	\$ (2,322)	\$ (7,924)	\$ 15,512

**Cash Flow Overview****Year Ended December 31, 2009**

For the year ended December 31, 2009, cash provided by operations was \$45.2 million. This was a result of net income of \$1.1 million, non-cash expenses of \$46.1 million (primarily depreciation and amortization, stock-based compensation, deferred income taxes, deferred rent expense and bad debt recovery) an increase in accrued expenses and other liabilities of \$13.9 million and a decrease in inventory of \$10.7 million, offset by the decrease in accounts payable of \$10.3 million and a decrease in income tax payable of \$9.9 million. The decrease in inventory levels during 2009 included a reduction in raw material purchases and moderated production in order to maintain lower levels of inventory in response to the declining economic environment and a projected decrease in demand from wholesale customers.

For the year ended December 31, 2009, we used \$20.9 million of cash in investing activities. This was primarily a result of increased investment in property and equipment of \$4.6 million for the U.S. wholesale, \$11.2 million for the U.S. Retail, \$1.4 million in the Canada segment and \$3.7 million in the International segment.

For year ended December 31, 2009, cash used in financing activities was \$25.5 million. This was primarily the result of using available cash and our new financing received from Lion to pay down our revolving credit facility and our previous term note and notes payable.

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**Year Ended December 31, 2008**

For the year ended December 31, 2008, cash provided by operations was \$18.9 million. This was a result of income from operations before non-cash expenses (primarily depreciation and amortization, stock-based compensation, deferred income taxes, deferred rent expense and bad debt recovery) of \$49.0 million, an increase in accounts payable and accrued expenses of \$21.4 million and an increase in income taxes payable of \$2.1 million, offset by the increase in inventory of \$44.6 million, increase in trade and other receivables of \$1.2 million and an increase in prepaid expenses and other current assets of \$8.1 million. The increase in inventory levels during 2008 included raw material purchases and production of product to support our growth in the U.S. Wholesale segment and continued expansion of the retail business in U.S. Retail, Canada and International segments.

For the year ended December 31, 2008, our used \$69.9 million of cash in investing activities. This was primarily a result of increased investment in property and equipment for the U.S. wholesale segment by approximately \$13.9 million and an increased investment in property and equipment of \$29.5 million for the U.S. Retail, \$4.7 million in the Canada segment and \$18.3 million in the International segment. In addition, we acquired all of the assets of a fabric dyeing and finishing plant for \$3.5 million.

For year ended December 31, 2008, cash provided by financing activities was \$41.2 million. This was primarily the result of our principal capital requirements to fund working capital needs and to finance opening of new retail stores, as well as to finance purchase of new manufacturing and information systems equipment to support higher production levels and growth in online operations. Proceeds from exercise of warrants amounted to \$65.6 million offset by the \$10.0 million repurchase of treasury shares and \$5.2 million to satisfy the applicable income tax withholding obligations in connection with the net share settlement of some of the Endeavor Warrants which is deemed to be a repurchase by our of its common stock. Other financing activities included receipt of a \$2.5 million loan from Dov Charney, offset by debt repayments and financing costs.

**Year Ended December 31, 2007**

For the year ended December 31, 2007, cash used in operations was \$(6.5) million. This was a result of income from operations before non-cash expenses (primarily depreciation and amortization, deferred income taxes, deferred rent expense and bad debt recovery) of \$(24.7) million, and an increase in income taxes payable of \$3.8 million, offset by the increase in inventory of \$22.2 million, decrease in receivables of \$0.5 million, increase in prepaid expenses and other current assets of \$2.3 million, and decrease in accounts payable and accrued expenses of \$8.4 million. Cash used in operations was primarily used to reduce obligations to trade and other vendors. Cash used in operations was also used to finance an increase in inventory production levels during the first two quarters of 2007 through raw material purchases to support American Apparel's peak selling season that generally occurs from the months of May through September, as well as a related increase in production selling and administrative staff payroll.

For the year ended December 31, 2007, we used \$22.7 million of cash in investing activities. This was partially a result of increased investment in property and equipment for the U.S. wholesale segment by approximately \$5.3 million and an increased investment in property and equipment of \$17.6 million for the U.S. retail and other segments. In 2007, we invested in new cutting, sewing, information systems equipment required to support the increased production levels experienced during 2007. Increase in investment in property and equipment for the retail segment was due to the 38 new retail stores that were opened in the year ended December 31, 2007.

For year ended December 31, 2007, cash from financing activities was \$44.5 million. This was primarily the result of \$123 million cash acquired in the Acquisition, the buyout of Sang Ho Lim, the other stockholder of Old American Apparel prior to the Acquisition, of \$67.9 million, decreases to the line of

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credit pursuant to the BofA Credit Agreement of \$2.7 million, increases to the term loans and notes payable pursuant to the SOF Credit Agreement of \$58.2 million offset by payments to term loans notes, payable and capital leases of \$41.9 million, and distributions and advances to stockholders of \$21.6 million. American Apparel's principal capital requirements were to fund working capital needs and to finance opening of new retail stores, as well as to finance purchases of new manufacturing and information systems equipment to support higher production levels and growth in online operations.

***Debt Agreements******Revolving Credit Facilities:***

On July 2, 2007, we replaced our, then existing, credit facility with an increased revolving credit facility (the BofA Agreement) of \$75 million from Bank of America, N.A (the Bank). Availability under the BofA Agreement, which is secured by substantially all of our assets, is calculated by a formula referencing the amounts of accounts receivable and inventory that we maintain at any given time. The BofA Agreement also imposes certain restrictions on us regarding capital expenditures and limits our ability to, among other things, incur additional indebtedness, dispose of assets, make repayments of indebtedness or amendments of debt instruments, pay distributions, create liens on assets and enter into sale and leaseback transactions, investments, loans or advances and acquisitions.

Borrowings under the BofA Agreement are subject to certain advance provisions established by the Bank and are collateralized by substantially all of our assets. Interest under the agreement is at LIBOR (0.25% at December 31, 2009) plus 4.5% or the Bank's prime rate (which rate can in no event be lower than LIBOR plus 4.5% per annum) (3.25% at December 31, 2009) plus 2.5%, at our option. In addition, the BofA Agreement requires us to maintain certain amounts of unused availability under the revolving credit facility. The BofA Agreement will mature on July 2, 2012. Net available borrowing capacity, reflecting outstanding letters of credit of approximately \$9.4 million and outstanding borrowings of \$6.2 million at December 31, 2009, was approximately \$41.2 million as determined based on our levels of inventory and amount of account receivables.

On December 30, 2009, our Canadian Companies replaced their secured revolving credit facility of C\$4.0 million from Toronto Dominion Bank, with an increased revolving credit facility (the BofM Agreement) of C\$11.0 million from Bank of Montreal (the Canadian Bank). The revolving credit facility is secured by movable hypothecs on all present and future movable property of our Canadian Companies. Borrowings under the BofM Agreement are subject to certain advance provisions established by the Canadian Bank. Interest under the agreement is at the Bank's prime rate (2.25% at December 31, 2009) plus 2%. The credit facility matures on December 30, 2012, and our available borrowing capacity at December 31, 2009 was C\$8.5 million.

***Long-term debt and capital lease obligations:***

On March 13, 2009, we entered into agreement with Lion Capital, LLC (Lion and the Lion Agreement, respectively), who provided us with term loans in an aggregate principal amount equal to \$80.0 million, of which \$5.0 million constituted a fee paid by us to Lion in accordance with the Lion Agreement. The term loans under the Lion Agreement mature on December 31, 2013 and bear interest at a rate of 15% per annum, payable quarterly in arrears. The Lion Agreement is subordinated to the BofA Agreement and contains customary representations and warranties, events of default, affirmative covenants and negative covenants (which impose restrictions and limitations on, among other things, dividends, investments, asset sales, capital expenditures and the ability of us to incur additional debt and liens) and a total leverage ratio financial maintenance covenant. We are permitted to prepay the loans in whole or in part at any time at our option, with no prepayment penalty.

Approximately \$51.3 million of the proceeds of the loans made under the Lion Agreement were used by us to repay in full all outstanding principal and interest due under the SOF Credit Agreement. The remaining proceeds were used to repay \$3.3 million of loans we owed to our CEO (see Note 13 to the consolidated financial

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statements contained elsewhere herein), to pay fees and expenses of \$4.3 million that were capitalized as deferred financing costs and included in other assets in the condensed consolidated balance sheet as of December 31, 2009, and to reduce the outstanding revolver balance under the BofA Credit Agreement by \$16.0 million. Accordingly, \$16.0 million of the revolver balance under the BofA Credit Agreement outstanding has been refinanced on a long-term basis and as of December 31, 2008 was reclassified to long-term debt.

In connection with the loans under the Lion Credit Agreement, we issued the Lion Warrant. We allocated the cash received from the Lion Credit Agreement between debt and warrants based on their relative fair values. The relative fair value of the debt under the Lion Credit Agreement was approximately \$56.0 million, based on a net present value of future cash flows using a discount rate of 21.6% determined by comparable financial instruments. The Lion Warrant was recorded as a debt discount and a credit to stockholders' equity at its relative fair value of approximately \$18.7 million. At December 31, 2009, the debt, net of unamortized discount and excluding interest paid-in-kind of \$6.1 million, totaled approximately \$59.7 million, and will be accreted up to the \$80.0 million par value of the loan using the effective interest method over the term of the Lion Credit Agreement. The Lion Warrant may be exercised by Lion by paying the exercise price in cash, pursuant to cashless exercise of the warrant or by a combination of the two methods. The Lion Warrant contains certain anti-dilution protections in favor of Lion providing for proportional adjustment of the warrant price and, under certain circumstances, the number of shares of the Company's common stock issuable upon exercise of the Lion Warrant, in connection with, among other things, stock dividends, subdivisions and combinations and the issuance of additional equity securities of the Company at less than fair market value.

As of December 31, 2009, we had outstanding approximately \$65.6 million of second lien debt, net of discount and including accrued paid-in-kind interest, payable to Lion, and we were in compliance with all covenants and restrictions under the Lion Credit Agreement.

We lease certain equipment under capital lease arrangements expiring at various times through September 2013. The assets and liabilities under capital leases are recorded at the lower of the present values of the minimum lease payments or the fair values of the assets.

**Related-party Debt:** As of December 31, 2009, we had outstanding approximately \$4.4 million of related party long-term debt payable to our CEO. The notes provide for interest at an annual rate of 6%, payable in kind, and are due in December 2012 and January 2013. One of the notes is subordinated to the Canadian revolving credit facility.

The following is an overview of our total debt as of December 31, 2009 (dollars in thousands).

Description of Debt	Lender Name	Stated Interest Rate	December 31, 2009	Covenant Violations
Revolving credit facility	Bank of America, N.A.	(LIBOR + 4.5%)	\$ 6,249	No
Revolving credit facility (Canada)	Bank of Montreal	4.25%		No
Term loan from private investment firm	Lion Capital LLP	15.0%	65,593	No
Other			501	N/A
Capital lease obligations	48 individual leases ranging between \$1-\$764	From 6.1% to 19.3%	2,927	N/A
Subordinated notes payable to related parties		6.0%	4,355	N/A
Cash overdraft			3,741	N/A
Total debt			\$ 83,366	

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### **Financial Covenants**

Our credit agreements impose certain restrictions regarding capital expenditures and limit our ability to: incur additional indebtedness, dispose of assets, make repayment of indebtedness or amendments of debt instruments, pay distributions, create liens on assets and enter into sale and leaseback transactions, investments, loans or advances and acquisitions.

The BofA Credit Agreement limits our domestic subsidiaries from incurring capital expenditures of more than approximately \$18.8 million, and the Lion Credit Agreement limits us from incurring capital expenditures of more than \$27.5 million, respectively, for the year ended December 31, 2009. The BofA Credit Agreement imposes a minimum excess availability covenant, which requires us to maintain minimum excess availability of 10% of our net availability under the credit agreement. The Lion Credit Agreement contains a total debt to consolidated EBITDA ratio financial covenant, as further described within the Lion Credit Agreement, which must be maintained at a level of no more than 2.20:1.00 for the quarters ended June 30, 2009, September 30, 2009, and December 31, 2009. The maximum ratio for future quarters is described further in the credit agreement and decreases successively from the 2.20:1.00 level. Additionally, the BofA Credit Agreement and Lion Credit Agreement contain cross-default provisions, whereby an event of default occurring under one of the credit agreements would cause an event of default under the other credit agreement.

The Bank of Montreal credit facility contains a fixed charge coverage ratio, tested at the end of each month, which measures the ratio of EBITDA less cash income taxes paid, dividends paid and unfinanced capital expenditures divided by interest expense plus scheduled principal payments of long term debt, debt under capital leases, dividends, and shareholder loans and advances, for our Canadian subsidiaries, of not less than 1.25:1.00. The Bank of Montreal credit facility also restricts our Canadian subsidiaries from entering into operating leases which would lead to payments under such leases totaling more than C\$8.5 million in any fiscal year, and imposes a minimum excess availability covenant which requires our Canadian subsidiaries to maintain at all times minimum excess availability of 5% of the revolving credit commitment under the credit facility.

As of December 31, 2009, we were in compliance with all covenants and restrictions under our credit facilities. We anticipate that based on our current operating plan for the next twelve months, we will remain in compliance with the covenants under the BofA Credit Agreement, Lion Credit Agreement and the Bank of Montreal credit facility. However, we can provide no assurances that we will maintain compliance with such covenants.

We were in compliance with the covenants under the Lion Credit Agreement as of December 31, 2009 and we anticipate that based on information currently available, we will be in compliance with the same covenants as of March 31, 2010. On March 31, 2010, the Company entered into a Second Amendment to the Lion Credit Agreement, which, among other things, increased the maximum permitted ratio Total Debt to Consolidated EBITDA (as defined in the Lion Credit Agreement) for the four quarter period ending March 31, 2010 from 1.75:1.00 to 2.00:1.00 and for the four quarter period ending June 30, 2010 from 1.70:1.00 to 1.90:1.00. The Second Amendment will enable the Company to make additional capital investments.

### ***Future Capital Requirements***

We had cash on hand of \$9.0 million at December 31, 2009. We are limited to \$18.8 million in capital expenditures, excluding non-cash property and equipment acquisitions, for fiscal 2010 for our U.S. operations, as set by restrictions in the BofA Credit Agreement, and \$27.5 million in capital expenditures as set by restrictions in the Lion Credit Agreement. Capital expenditures are primarily necessary to fund the opening of new stores and the remodeling of existing stores, and the purchase of manufacturing equipment, distribution center equipment and computer hardware and software.

**Table of Contents****Off-Balance Sheet Arrangements and Contractual Obligations**

Our material off-balance sheet contractual commitments are operating lease obligations and letters of credit. These items were excluded from the balance sheet in accordance with GAAP.

Operating lease commitments consist principally of leases for our retail stores, manufacturing facilities, main distribution center and corporate office. These leases frequently include options which permit us to extend the terms beyond the initial fixed lease term. With respect to most of those leases, we intend to renegotiate the leases as they expire. Issued and outstanding letters of credit were \$9.4 million at December 31, 2009, and were related primarily to workers' compensation insurance and rent deposits. We also have capital lease obligations which consist principally of leases for our manufacturing equipment.

**Contractual Obligations Summary**

The following table summarizes our contractual commitments as of December 31, 2009, which relate to future minimum payments due under non-cancelable licenses, leases, revolving credit facility, long-term debt and advertising commitments. Future minimum rental payment on operating lease obligations presented below do not include any related property insurance, taxes, maintenance or other related costs required by operating leases. Operating lease rent expenses, including the related real estate taxes and maintenance costs, are included in the cost of sales and general and administrative expenses in our consolidated financial statements and amounted to approximately \$79.3 million for the year ended December 31, 2009.

Contractual Obligations	Total	Payments due by period			
		Less than 1 year	1-3 years	4-5 years	More than 5 years
Long term debt, including interest	\$ 110,648	\$ 9,839	\$ 21,600	\$ 78,911	\$ 298
Current debt, including interest	6,972	6,972			
Capital lease obligations, including interest	3,183	2,079	927	177	
Operating lease obligations	460,033	67,610	126,432	114,095	151,896
Advertising commitments	3,567	3,567			
Self insurance reserves	11,714	4,807	4,211	1,748	948
<b>Total contractual obligations</b>	<b>\$ 596,117</b>	<b>\$ 94,874</b>	<b>\$ 153,170</b>	<b>\$ 194,931</b>	<b>\$ 153,142</b>

We had approximately \$5.2 million of total gross unrecognized tax benefits, including interest. The timing of any payments which could result from these unrecognized tax benefits will depend on a number of factors, and accordingly the amount and timing of any future payments cannot be reasonably estimated. We do not expect a significant tax payment related to these benefits within the next year. Therefore, these amounts are not included in the table above.

**Seasonality**

We experience seasonality in our operations. Historically, sales during the second and third fiscal quarters have generally been the highest, with sales during the first fiscal quarter the lowest. This reflects the combined impact of the seasonality of our wholesale and retail sales channels. Generally, our retail sales channel has not experienced the same pronounced sales seasonality as other retailers.

**Inflation**

Inflation affects the cost of raw materials, goods and services used in our operations. In recent years, inflation has been modest. However, high oil costs can affect the cost of all raw materials and components. The competitive environment limits the ability of American Apparel to recover higher costs resulting from inflation by raising prices. Although we cannot precisely determine the effects of inflation on its business, we believe that the effects on revenues and operating results have not been significant. We seek to mitigate the adverse effects of



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inflation primarily through improved productivity and strategic buying initiatives. We do not believe that inflation has had a material impact on our results of operations for the periods presented, except with respect to payroll-related costs and other costs arising from or related to government imposed regulations.

### **Critical Accounting Estimates and Policies**

Complete descriptions of our significant accounting policies are outlined in Note 3 of the Notes to consolidated financial statements included elsewhere in this Annual Report on Form 10-K. The preparation of financial statements in conformity with generally accepted accounting principles in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Management bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources.

Our critical accounting estimates and policies include:

revenue recognition

sales returns and other allowances;

allowance for doubtful accounts;

inventory valuation, obsolescence;

valuation and recoverability of long-lived intangible assets including the values assigned to acquired intangible assets, goodwill, and property and equipment;

income taxes;

foreign currency;

accruals for the outcome of current litigation.

self insurance liabilities

In general, estimates are based on historical experience, on information from third party professionals and on various other sources and assumptions that are believed to be reasonable under the facts and circumstances at the time such estimates are made. On a continual basis, management reviews its estimates utilizing currently available information, changes in facts and circumstances, historical experience and reasonable assumptions. After such reviews, and if deemed appropriate, those estimates are adjusted accordingly. Actual results may vary from these estimates and assumptions under different and/or future circumstances. Our management considers an accounting estimate to be critical if:

it requires assumptions to be made that were uncertain at the time the estimate was made; and

changes in the estimate, or the use of different estimating methods that could have been selected, could have a material impact on our consolidated results of operations or financial condition.

**Revenue Recognition**

We recognize product sales when title and risk of loss have transferred to the customer, there is persuasive evidence of an arrangement, the sales price is fixed or determinable and collectability is reasonably assured. Wholesale product sales are recorded at the time the product is either picked up by or shipped to the customer. Online product sales are recorded at the time the products are received by the customers. Retail store sales are recorded as revenue upon the sale of product to retail customers. Our net sales represent gross sales invoiced to customers, less certain related charges for discounts, returns, and other promotional allowances and are recorded

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net of sales or value added tax. Allowances provided for these items are presented in the consolidated financial statements primarily as reductions to sales and cost of sales (see Sales Returns and Allowances discussed below for further information).

We recognize revenues from gift cards, gift certificates and store credits as they are redeemed for product. Prior to redemption, we maintain an unearned revenue liability for gift cards, gift certificates and store credits until we are released from such liability, as we do not currently have sufficient historical evidence to recognize gift card breakage. Our gift cards, gift certificates and store credits do not have expiration dates.

### **Sales Returns and Allowances**

We analyze sales returns in order to make reasonable and reliable estimates of product returns for our wholesale, online product sales and retail store sales based upon historical experience. We also monitor the buying patterns of the end-users of our products based on sales data received by our retail outlets. Estimates for sales returns are based on a variety of factors including actual returns based on expected return data communicated to it by customers. Accordingly, we believe that its historical returns analysis is an accurate basis for its allowance for sales returns. As with any set of assumptions and estimates, there is a range of reasonably likely amounts that may be calculated for our allowance for sales returns above. However, we believe that there would be no significant difference in the amounts reported using other reasonable assumptions than what was used to arrive at the allowance. We regularly review the factors that influence our estimates and, if necessary, make adjustments when we believe that actual product returns and credits may differ from established reserves. Actual experience may be significantly different than our estimates due to various factors, including, but not limited to, changes in sales volume based on consumer demand and competitive conditions. If actual or expected future returns and claims are significantly greater or lower than the allowance for sales returns established, we would record a reduction or increase to net revenues in the period in which it made such determination.

### **Trade Receivables and Allowance for Doubtful Accounts**

Accounts receivable primarily consists of trade receivables, including amounts due from credit card companies, net of allowances. On a periodic basis, we evaluate our trade receivables and establish an allowance for doubtful accounts based on our history of past bad debt expense, collections and current credit conditions.

We perform on-going credit evaluations of our customers and adjust credit limits based upon payment history and the customer's current credit worthiness, as determined by our review of their current credit information. Collections and payments from customers are continuously monitored. We maintain an allowance for doubtful accounts, which is based upon historical experience as well as specific customer collection issues that have been identified. While such bad debt expenses have historically been within expectations and allowances established, we cannot guarantee that we will continue to experience the same credit loss rates that we have in the past. If the financial condition of customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

### **Inventories**

Inventories are stated at the lower of cost or market. Cost is primarily determined on the first-in, first-out ( FIFO ) method. We identify potential excess and slow-moving inventories by evaluating turn rates, inventory levels and other factors. Excess quantities are identified through evaluation of inventory aging, review of inventory turns and historical sales experiences. At times however, we will purposefully engage in inventory build up at a rate that outpaces sales. This is typically done during the first and second quarters in anticipation of the peak selling season which occurs during the summer months of the second and third quarters each year. At such times, we will consider the timing of inventory buildup in order to determine whether the buildup warrants additional reserves for inventory obsolescence. If the inventory buildup occurs in advance of the selling season, management maintains the existing reserve for excess and slow-moving inventory until the peak selling season has passed and the accumulated sales data provides a better basis for an update of our management's estimate of this provision.

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We have evaluated the current level of inventories considering historical sales and other factors and, based on this evaluation, have recorded adjustments to cost of goods sold to adjust inventories to net realizable value. These adjustments are estimates, which could vary significantly, either favorably or unfavorably, from actual requirements if future economic conditions, customer demand or competition differ from expectations. Other significant estimates include the allocation of variable and fixed production overheads. While variable production overheads are allocated to each unit of production on the basis of actual use of production facilities, the allocation of fixed production overhead to the costs of conversion is based on the normal capacity of our production facilities, and recognizes abnormal idle facility expenses as current period charges. Certain costs, including categories of indirect materials, indirect labor and other indirect manufacturing costs which are included in the overhead pools are estimated. We determine our normal capacity based upon the amount of direct labor minutes in a reporting period.

### **Goodwill and Other Intangible Assets**

Goodwill and other intangible assets acquired in a business combination and determined to have an indefinite useful life are not amortized, but instead tested for impairment at least annually in accordance with the provisions of Accounting Standards Update ( ASC 350 ),

Intangibles Goodwill and Other . The goodwill impairment model is a two-step process. The first step compares the fair value of a reporting unit that has goodwill assigned to its carrying value. We estimate the fair value of a reporting unit by using a discounted cash flow model. If the fair value of the reporting unit is determined to be less than its carrying value, a second step is performed to compute the amount of goodwill impairment, if any. Step two allocates the fair value of the reporting unit to the reporting unit's net assets other than goodwill. The excess of the fair value of the reporting unit over the amounts assigned to its net assets other than goodwill is considered the implied fair value of the reporting unit's goodwill. The implied fair value of the reporting unit's goodwill is then compared to the carrying value of its goodwill. Any shortfall represents the amount of goodwill impairment. We completed the annual impairment test of our goodwill as of December 31, 2009 and 2008 and determined that there was not impairment as the fair value of the reporting unit, to which goodwill was assigned, substantially exceeded the carrying value of the reporting unit.

### **Long-Lived Assets**

We follow the provisions of ASC 360 Property, Plant and Equipment , which requires evaluation of the need for an impairment charge relating to long-lived assets whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The estimated future undiscounted cash flows associated with the asset would be compared to the asset's carrying amount to determine if a write down to a new depreciable basis is required. If required, an impairment charge is recorded based on an estimate of future discounted cash flows.

We consider the following to be some examples of important indicators that may trigger an impairment review: (i) significant under-performance or losses of retail stores relative to expected historical or projected future operating results; (ii) significant changes in the manner or use of the assets or in our overall strategy with respect to the manner or use of the acquired assets or changes in our overall business strategy; (iii) significant negative industry or economic trends; (iv) increased competitive pressures; (v) a significant decline in American Apparel's stock price for a sustained period of time; and (vi) regulatory changes.

We evaluate acquired assets and our retail stores for potential impairment indicators at least annually and more frequently upon the occurrence of certain events. Judgment regarding the existence of impairment indicators is based on market conditions and operational performance of the acquired businesses. Future events could cause us to conclude that impairment indicators exist, and therefore long lived assets could be impaired. Such evaluations are significantly impacted by estimates of future revenues, costs and expenses and other factors. A significant change in cash flows in the future could result in an impairment of long lived assets. During the years ended December 31, 2009, 2008 and 2007 we recorded an impairment charge in the amount of \$3.3

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million, \$0.6 million and \$0.3 million related to underperforming retail stores located in each of the U.S. Retail, Canada and International segments.

### **Income Taxes**

We record the estimated future tax effects of temporary differences between the tax basis of assets and liabilities and amounts reported in our accompanying consolidated balance sheets, as well as tax credit carrybacks and carryforwards. We periodically review the recoverability of deferred tax assets recorded on our balance sheet and provide valuation allowances as management deems necessary. Management makes judgments as to the interpretation of the tax laws that might be challenged upon an audit and cause changes to previous estimates of tax liability. In addition, we operate within multiple taxing jurisdictions and are subject to audit in these jurisdictions. In management's opinion, adequate provisions for income taxes have been made for all years. If actual taxable income by tax jurisdiction varies from estimates, additional allowances or reversals of reserves may be necessary.

### **Foreign Currency**

In preparing our consolidated financial statements, the financial statements of the foreign subsidiaries are translated from the functional currency, generally the local currency, into U.S. Dollars. This process results in exchange rate gains and losses, which, under the relevant accounting guidance, are included as a separate component of stockholders' equity under the caption Accumulated other Comprehensive Income.

Under the relevant accounting guidance, the functional currency of each foreign subsidiary is determined based on management's judgment and involves consideration of all relevant economic facts and circumstances affecting the subsidiary. Generally, the currency in which the subsidiary transacts a majority of its transactions, including billings, financing, payroll and other expenditures, would be considered the functional currency, but any dependency upon the parent and the nature of the subsidiary's operations must also be considered.

If a subsidiary's functional currency is deemed to be the local currency, then any gain or loss associated with the translation of that subsidiary's financial statements is included in accumulated other comprehensive income. However, if the functional currency is deemed to be the U.S. Dollar, then any gain or loss associated with the re-measurement of these financial statements from the local currency to the functional currency would be included within the statement of operations. If we dispose of subsidiaries, then any cumulative translation gains or losses would be recorded into our statement of operations. If we determine that there has been a change in the functional currency of a subsidiary to the U.S. Dollar, any translation gains or losses arising after the date of change would be included within the statement of operations.

Based on an assessment of the factors discussed above, we consider the relevant subsidiary's local currency to be the functional currency for each of our foreign subsidiaries.

### **Contingencies**

We are subject to proceedings, lawsuits and other claims related to various matters. We assess the likelihood of any adverse judgments or outcomes to these matters as well as potential ranges of probable losses. Management determines the amount of reserves needed, if any, for each individual issue based on its knowledge and experience and discussions with legal counsel. The required reserves may change in the future due to new developments in each matter, the ultimate resolution of each matter or changes in approach, such as a change in settlement strategy, in dealing with these matters. We currently do not believe, based upon information available at this time, that these matters will have a material adverse effect on our consolidated financial position, results of operations or cash flows. However, there is no assurance that such matters will not materially and adversely affect the Company's business, financial position, and results of operations or cash flows. See Note 16 and 21 to our consolidated financial statements included elsewhere in this Annual Report on Form 10-K.

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### **Self insurance liabilities**

We maintain self-insurance programs for our estimated commercial general liability risk and our estimated workers' compensation liability risk related to our manufacturing and retail operations in the United States. In addition, starting in October 2008, we have a self-insurance program for a portion of our employee medical benefits covering all employees in the United States. Under these programs, we maintain insurance coverage for losses in excess of specified per-occurrence amounts. Estimated costs under the workers' compensation program, including incurred but not reported claims, are recorded as expense based upon historical experience, trends of paid and incurred claims, and other actuarial assumptions. If actual claims trends under these programs, including the severity or frequency of claims, differ from our estimates, our financial results may be significantly impacted. Our estimated self-insurance liabilities are classified in our balance sheet as accrued expenses or other long-term liabilities based upon whether they are expected to be paid during or beyond our normal operating cycle of 12 months from the date of our consolidated financial statements. As of December 31, 2009 and 2008, our self-insurance liabilities totaled \$11.7 million and \$8.4 million, respectively.

### **Accounting Pronouncements-Newly Issued**

See Note 3 to the consolidated financial statements contained elsewhere in this Annual Report on Form 10-K.

### **Item 7A. Quantitative and Qualitative Disclosures about Market Risks (amounts in thousands)**

Our exposure to market risk is limited to interest rate risk associated with our credit facilities and foreign currency exchange risk associated with our foreign operations.

#### ***Interest Rate Risk***

Based on our interest rate exposure on variable rate borrowings at December 31, 2009, a 1% increase in average interest rates on our borrowings would increase future interest expense by approximately \$5k per month. We determined this amount based on approximately \$6.2 million of variable rate borrowings at December 31, 2009. We are currently not using any interest rate collars or hedges to manage or reduce interest rate risk. As a result, any increase in interest rates on the variable rate borrowings would increase interest expense and reduce net income.

#### ***Foreign Currency Risk***

The majority of our operating activities are conducted in U.S. dollars. Approximately 40.4% of our net sales for the year ended December 31, 2009 were denominated in other currencies such as Euros, British Pounds Sterling or Canadian Dollars. Nearly all of our production costs and material costs are denominated in U.S. dollars although the majority of the yarn is sourced from outside the United States. If the U.S. dollar were to appreciate by 10% against other currencies it could have a significant adverse impact on our earnings. Since an appreciated U.S. dollar makes goods produced in the United States relatively more expensive to overseas customers, other things being equal, we would have to lower our retail margin in order to maintain sales volume overseas. A lower retail margin overseas would adversely affect net income assuming sales volume remains the same. The functional currencies of our foreign operations consist of the Canadian dollar for Canadian subsidiaries, the pound Sterling for U.K. subsidiaries, the Euro for subsidiaries in Continental Europe, the Yen for the Japanese subsidiary, the Won for the South Korea subsidiary, and local currencies for any of the foreign subsidiaries not mentioned.

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**American Apparel, Inc.**

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AND FINANCIAL STATEMENT SCHEDULE**

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Audit Committee of the  
Board of Directors and Stockholders of  
American Apparel, Inc.

We have audited the accompanying consolidated balance sheet of American Apparel, Inc. and subsidiaries as of December 31, 2009, and the related consolidated statements of operations, stockholders' equity and comprehensive income (loss), and cash flows for the year ended December 31, 2009. Our audit also included the financial statement schedule as of and for the year ended December 31, 2009 listed in Item 15(a)(2). These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of American Apparel, Inc. and subsidiaries as of December 31, 2009, and the results of their operations and their cash flows for the year ended December 31, 2009, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such consolidated financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), our internal control over financial reporting as of December 31, 2009, based on the criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 31, 2010 expressed an adverse opinion on the Company's internal control over financial reporting because of material weaknesses.

/s/ Deloitte & Touche LLP

Los Angeles, California

March 31, 2010



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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Audit Committee of the

Board of Directors and Stockholders of

American Apparel, Inc.

We have audited the accompanying consolidated balance sheet of American Apparel, Inc. (the Company) as of December 31, 2008, and the related consolidated statements of operations, stockholders' equity and comprehensive income (loss) and cash flows for the years ended December 31, 2008 and 2007. Our audits also included the financial statement schedule for the years ended December 31, 2008 and 2007 listed in the index at Item 15. These consolidated financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of American Apparel, Inc. as of December 31, 2008, and the consolidated results of its operations and its cash flows for the years ended December 31, 2008 and 2007 in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole presents fairly, in all material respects, the information set forth therein.

/s/ Marcum LLP

(formerly Marcum & Kliegman LLP)

New York, NY

March 16, 2009, except for the restatement discussed in Note 20 (not presented herein) to the consolidated financial statements appearing under Item 8 of the Company's 2008 Annual Report on Form 10-K/A filed on August 13, 2009, as to which the date is August 12, 2009.

**Table of Contents****Item 8. Financial Statements and Supplementary Data****American Apparel, Inc. and Subsidiaries****Consolidated Balance Sheets**

(Amounts in Thousands, except par value)

	December 31,	
	2009	2008
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash	\$ 9,046	\$ 11,368
Trade accounts receivable, net of allowances of \$1,763 and \$1,441 at December 31, 2009 and 2008, respectively	16,907	16,439
Prepaid expenses and other current assets	9,994	5,369
Inventories	141,235	148,154
Income taxes receivable	4,494	604
Deferred income taxes	4,627	3,935
Total current assets	186,303	185,869
<b>PROPERTY AND EQUIPMENT, net</b>	<b>103,310</b>	<b>112,408</b>
<b>DEFERRED INCOME TAXES</b>	<b>12,033</b>	<b>10,137</b>
<b>OTHER ASSETS, net</b>	<b>25,933</b>	<b>25,195</b>
<b>TOTAL ASSETS</b>	<b>\$ 327,579</b>	<b>\$ 333,609</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Cash overdraft	\$ 3,741	\$ 2,413
Revolving credit facilities and current portion of long-term debt	6,346	34,318
Accounts payable	19,705	32,731
Accrued expenses	30,573	22,140
Income taxes payable	2,608	8,582
Current portion of capital lease obligations	1,907	2,616
Total current liabilities	64,880	102,800
<b>LONG-TERM DEBT, net of unamortized discount of \$20,537 at December 31, 2009 and none at December 31, 2008</b>	<b>65,997</b>	<b>67,050</b>
<b>SUBORDINATED NOTES PAYABLE TO RELATED PARTY</b>	<b>4,355</b>	<b>3,292</b>
<b>CAPITAL LEASE OBLIGATIONS, net of current portion</b>	<b>1,020</b>	<b>1,986</b>
<b>DEFERRED RENT</b>	<b>22,052</b>	<b>16,011</b>
<b>OTHER LONG-TERM LIABILITIES</b>	<b>11,934</b>	<b>6,058</b>
<b>TOTAL LIABILITIES</b>	<b>170,238</b>	<b>197,197</b>
<b>COMMITMENTS AND CONTINGENCIES (Note 18)</b>		
<b>STOCKHOLDERS EQUITY</b>		
Preferred stock, \$.0001 par value, authorized 1,000 shares; none issued		
Common stock, \$.0001 par value, authorized 120,000 shares; 72,467 shares issued and 71,033 shares outstanding at December 31, 2009 and 72,221 shares issued and 70,787 shares outstanding at December 31, 2008	7	7
Additional paid-in capital	150,449	131,252
Accumulated other comprehensive loss	(2,083)	(2,703)
Retained earnings	19,012	17,900

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Less: Treasury stock, 1,434 shares at cost	167,385 (10,044)	146,456 (10,044)
TOTAL STOCKHOLDERS EQUITY	157,341	136,412
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	\$ 327,579	\$ 333,609

*See accompanying notes to consolidated financial statements.*

**Table of Contents****American Apparel, Inc. and Subsidiaries****Consolidated Statements of Operations**

(Amounts in Thousands, except per share amounts)

	Years ended December 31,		
	2009	2008	2007
Net sales	\$ 558,775	\$ 545,050	\$ 387,044
Cost of sales (including share-based compensation of \$12,102 for the year ended December 31, 2008)	238,863	250,629	173,676
Gross profit	319,912	294,421	213,368
Operating expenses (including share-based compensation of \$525, \$530 and \$0 for the years ended December 31, 2009, 2008 and 2007, respectively, and related party charges of \$622, \$619 and \$6,111 for the years ended December 31, 2009, 2008 and 2007, respectively)	295,497	258,357	182,246
Income from operations	24,415	36,064	31,122
Interest expense (including related party interest expense of \$271, \$346 and \$1,633 for the years ended December 31, 2009, 2008 and 2007, respectively)	22,627	13,921	17,541
Foreign currency transaction (gain) loss	(2,920)	621	(722)
Other (income) expense	(220)	155	(980)
Income before income taxes	4,928	21,367	15,283
Income tax provision (benefit)	3,816	7,255	(195)
Net income	\$ 1,112	\$ 14,112	\$ 15,478
Basic earnings per share	\$ 0.02	\$ 0.20	\$ 0.32
Diluted earnings per share	\$ 0.01	\$ 0.20	\$ 0.31
Weighted average basic shares outstanding	71,026	69,490	48,890
Weighted average diluted shares outstanding	76,864	70,317	49,414
<b>PRO FORMA COMPUTATION RELATED TO CONVERSION TO C CORPORATION</b>			
<b>FOR INCOME TAX PURPOSES (unaudited):</b>			
Historical income before income taxes			\$ 15,283
Pro forma provision for income taxes			5,826
Pro forma net income			\$ 9,457
Pro forma Basic Earnings per share			\$ 0.19
Pro forma Diluted Earnings per share			\$ 0.19

*See accompanying notes to consolidated financial statements.*

**Table of Contents****American Apparel, Inc. and Subsidiaries****Consolidated Statements of Stockholders Equity and Comprehensive Income (Loss)**

(Amounts in Thousands)

	Number of Common Shares	Par Value Amount	Treasury Stock	Additional Paid-in Capital	Due from Stockholders	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total Stockholders Equity	Comprehensive Income (Loss)
<b>BALANCE, January 1, 2007</b>	<b>48,390</b>	<b>\$ 5</b>	<b>\$</b>	<b>\$ 6,197</b>	<b>\$ (553)</b>	<b>\$ 361</b>	<b>\$ 6,963</b>	<b>\$ 12,973</b>	
Outstanding shares of the Registrant at time of reverse merger dated December 12, 2007	19,933	2		121,587				121,589	
Buy out of Sang Ho Lim	(11,132)	(1)		(67,902)				(67,903)	
Repayment of stockholders advances					553			553	
Distributions to stockholders				(15,764)			(6,383)	(22,147)	
Reclass deferred merger costs				(1,003)				(1,003)	
Imputed interest on stockholder loans				577				577	
Capitalization of undistributed S Corporation earnings				12,270			(12,270)		
Exercise of warrants	200			1,200				1,200	
Cashless exercise of underwriters unit purchase options	204								
Net income							15,478	15,478	\$ 15,478
Foreign currency translation, net of tax						504		504	504
<b>BALANCE, December 31, 2007</b>	<b>57,595</b>	<b>6</b>		<b>57,162</b>		<b>865</b>	<b>3,788</b>	<b>61,821</b>	<b>\$ 15,982</b>
Exercise of Warrants	13,521	1		65,617				65,618	
Purchase of treasury stock			(10,044)					(10,044)	
Issuance of common stock for stock-based compensation, net of payroll tax withholding	1,105			7,452				7,452	
Issuance of warrants				1,021				1,021	
Net income							14,112	14,112	\$ 14,112
Foreign currency translation, net of tax						(3,568)		(3,568)	(3,568)
<b>BALANCE, December 31, 2008</b>	<b>72,221</b>	<b>7</b>	<b>(10,044)</b>	<b>131,252</b>		<b>(2,703)</b>	<b>17,900</b>	<b>136,412</b>	<b>\$ 10,544</b>
Issuance of common stock for stock-based compensation	246			525				525	
Issuance of warrants				18,672				18,672	
Net income							1,112	1,112	\$ 1,112

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Foreign currency translation, net of tax						620		620	620
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<b>BALANCE, December 31, 2009</b>	<b>72,467</b>	<b>\$ 7</b>	<b>\$ (10,044)</b>	<b>\$ 150,449</b>	<b>\$</b>	<b>\$ (2,083)</b>	<b>\$ 19,012</b>	<b>\$ 157,341</b>	<b>\$ 1,732</b>
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*See accompanying notes to consolidated financial statements.*

**Table of Contents****American Apparel, Inc. and Subsidiaries****Consolidated Statements of Cash Flows**

(Amounts in Thousands)

	For the Years ended December 31,		
	2009	2008	2007
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Cash received from customers	\$ 559,089	\$ 544,062	\$ 386,931
Cash paid to suppliers, employees and others	(491,873)	(501,469)	(373,653)
Income taxes paid	(13,886)	(11,351)	(3,247)
Interest paid, net of capitalized interest	(8,609)	(12,194)	(17,533)
Other	482	(162)	1,006
Net cash provided by (used in) operating activities	45,203	18,886	(6,496)
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Capital expenditures	(20,889)	(66,365)	(21,137)
Purchase of net assets under business acquisition		(3,500)	(1,600)
Net cash used in investing activities	(20,889)	(69,865)	(22,737)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Cash overdraft from financial institution	1,307	(288)	(1,212)
(Repayment) borrowings under revolving credit facility, net	(43,590)	1,381	(2,659)
Deferred financing costs paid	(5,003)	(4,139)	(1,630)
Distribution to stockholders, net			(21,594)
Proceeds from exercise of warrants		65,619	1,200
Purchase of treasury stock		(10,044)	
Repurchase of common stock for payment of payroll statutory tax withholding on stock-based compensation		(5,174)	
Cash acquired in reverse Merger			123,000
Buy out of Sang Ho Lim			(67,903)
Payment of merger-related costs			(1,003)
Borrowings of subordinated notes payable to related party	4,000	2,500	4,732
Repayments under subordinated notes payable to related party	(3,250)	(4,580)	(7,164)
Borrowings under notes payable to unrelated parties		966	2,118
Repayment under notes payable to unrelated parties		(1,336)	(8,288)
Repayment of subordinated note payable to unrelated party			(14,201)
Borrowings under term loans and notes payable, net of \$5,000 discount	75,074		51,386
Repayment of term loans and notes payable	(51,183)		(8,685)
Repayment of capital lease obligations	(2,826)	(3,734)	(3,567)
Net cash (used in) provided by financing activities	(25,471)	41,171	44,530
<b>EFFECT OF FOREIGN EXCHANGE RATE CHANGES ON CASH</b>	(1,165)	1,884	215
<b>NET (DECREASE) INCREASE IN CASH</b>	(2,322)	(7,924)	15,512
<b>CASH, beginning of period</b>	11,368	19,292	3,780
<b>CASH, end of period</b>	\$ 9,046	\$ 11,368	\$ 19,292

See accompanying notes to consolidated financial statements.





**Table of Contents****American Apparel, Inc. and Subsidiaries****Consolidated Statements of Cash Flows (Continued)**

(Amounts in Thousands)

	Years ended December 31,		
	2009	2008	2007
<b>RECONCILIATION OF NET INCOME TO NET CASH PROVIDED BY (USED IN)</b>			
<b>OPERATING ACTIVITIES</b>			
Net income	\$ 1,112	\$ 14,112	\$ 15,478
Depreciation and amortization of property and equipment and other assets	28,151	20,844	13,306
Amortization of debt discount and deferred financing costs	7,713	1,030	583
Loss on disposal of property and equipment	246		
Foreign currency transaction (gain) loss	(2,920)	621	(722)
Imputed interest on stockholder loans			577
Accrued interest paid in kind	6,312		
Retail store impairment charges	3,343	644	252
Stock-based compensation expense	525	12,625	
Bad debt expense (recovery)	492	598	(313)
Deferred income taxes	(3,704)	(6,212)	(6,913)
Deferred rent	5,908	7,746	2,594
Changes in cash due to changes in operating assets and liabilities:			
Trade accounts receivables	(178)	(816)	(499)
Inventories	10,669	(46,361)	(21,621)
Prepaid expenses and other current assets	(4,874)	(376)	(2,298)
Other assets	(1,246)	(9,083)	(2,297)
Accounts payable	(10,297)	15,197	(16,893)
Accrued expenses and other liabilities	13,853	6,196	8,503
Income taxes receivable/payable	(9,902)	2,121	3,767
Net cash provided by (used in) operating activities	\$ 45,203	\$ 18,886	\$ (6,496)
<b>NON-CASH INVESTING AND FINANCING ACTIVITIES</b>			
Property and equipment acquired under a capital lease	\$ 1,151	\$ 1,092	\$ 4,614
Property and equipment acquired and included in accounts payable	\$ 764	\$ 2,285	\$ 1,058
Liabilities assumed under Endeavor Acquisition	\$	\$	\$ 1,411
Reclassification of advances to stockholders	\$	\$	\$ 553