

AMERICAN APPAREL, INC
Form 10-K
March 25, 2015
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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, 2014

OR

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period _____ to _____

Commission File Number 001-32697

American Apparel, Inc.
(Exact name of registrant as specified in its charter)

Delaware
(State of Incorporation)
747 Warehouse Street
Los Angeles, California 90021-1106
(Address of principal executive offices)
Registrant's telephone number, including area code: (213) 488-0226

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

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

Common Stock, par value \$0.0001 per share
(Title of Each Class)

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

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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 (§232.405 of this chapter) 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 (§229.405 of this chapter) 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 "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act:

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

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 at June 30, 2014 was \$85,370,030 (which represents 94,855,589 shares of common stock held by non-affiliates multiplied by \$0.90, the closing sales price on the NYSE MKT LLC for such date).

At March 13, 2015, the Registrant had issued and outstanding 176,566,222 and 176,260,566 shares of its common stock, respectively.

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DOCUMENTS INCORPORATED BY REFERENCE

Certain information from the Registrant's definitive proxy statement for the 2015 Annual Meeting of Stockholders (the "2015 Proxy Statement"), to be filed within 120 days of the end of the fiscal year ended December 31, 2014, is incorporated by reference into Part III hereof. Except with respect to the information specifically incorporated by reference in Part III of this Form 10-K, the 2015 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," "expect," "believe," "plan," "estimate," "potential," "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," "opportunity," "comfortable," "anticipate," "current," "intention," "position," "assume," "outlook," "remain," "maintain," "sustain," "seek," "achieve," and similar expressions.

Any statements that refer to projections of our future financial performance, anticipated growth and trends in our business, 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:

- consequences of the termination of Dov Charney, our former chief executive officer (or the internal investigation related thereto), including any litigation or regulatory investigations, or any impact on our sales or brand related thereto;
- ability to hire and/or retain qualified employees, including executive officers;
- our future financial condition, results of operations, plans and prospects, expectations, operating improvements and cost savings, and the timing of any of the foregoing;
- growth, expansion and acquisition prospects and strategies, the success of such strategies, and the benefits we believe can be derived from such strategies;
- our ability to make debt payments; ability to remain in compliance with financial covenants under financing arrangements; and ability to obtain appropriate waivers or amendments with respect to any noncompliance;
- liquidity and projected cash flows;
- plans to make continued investments in advertising and marketing;
- the outcome of investigations, enforcement actions and litigation matters, including exposure that could exceed expectations;
- intellectual property rights and those of others, including actual or potential competitors, our personnel, consultants, and collaborators;
- trends in raw material costs and other costs both in the industry and specific to us;
- the supply of raw materials and the effects of supply shortages on our financial condition, results of operations, and cash flows;
- economic and political conditions;
- currency fluctuations and the impact thereof;
- overall industry and market performance;
- operations outside the U.S.;
- the impact of accounting pronouncements;
- ability to maintain compliance with the listing requirements of NYSE MKT LLC;
- ability to improve efficiency and control costs at our production and supply chain facilities; 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 and those expressed in or implied by

the forward-looking statements. Such assumptions, events, risks, uncertainties and other factors are found in "Item 1A. Risk Factors" in Part I and elsewhere in this Annual Report on Form 10-K and other reports and documents we file with the Securities and Exchange Commission (the "SEC") and include, without limitation, the following: consequences of the termination of Dov Charney, our former chief executive officer (or the internal investigation related thereto), including any litigation or regulatory investigations, or any impact on our sales or brand related thereto;

- changes in key personnel, our ability to hire and retain key personnel, and our relationship with our employees;
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• voting control by our directors, lenders and other affiliates, including Standard General and Dov Charney;

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

• ability to effectively carry out and manage our strategy;

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

- general economic conditions, geopolitical events, other regulatory changes, and inflation or deflation;

• disruptions in the global financial markets;

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

- risks associated with fluctuations and trends of consumer apparel spending in the U.S.;

• changes in consumer preferences or demand for our products;

• our ability to attract customers to our retail and online stores;

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

- seasonality and fluctuations in comparable store sales and wholesale net sales and associated margins;

• ability to improve manufacturing efficiency at our production facilities;

• changes in the price of materials and labor, including increases in the price of raw materials in the global market and minimum wages;

• ability to pass on the added cost of raw materials and labor to customers;

• ability to effectively manage inventory levels;

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

• ability to renew leases on economic terms;

• risks associated with our facilities being concentrated in one geographic area;

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

• ability to generate or obtain from external sources sufficient liquidity for operations and debt service;

• consequences of our significant indebtedness, including our relationships with lenders, ability to comply with debt agreements, ability to generate cash flow to service our debt, and the risk of acceleration of borrowings thereunder as a result of noncompliance;

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

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

• loss of U.S. import protections or changes in duties, tariffs and quotas, risks associated with our foreign operations and supply sources such as market disruption, changes in import and export laws, and currency restrictions and exchange rate fluctuations;

• litigation and other inquiries and investigations, including the risks that we, our officers or directors in cases where indemnification applies, will not be successful in defending any proceedings, lawsuits, disputes, claims or audits, and that exposure could exceed expectations or insurance coverage;

• tax assessments by domestic or foreign governmental authorities, including import or export duties on our products and the applicable rates for any such taxes or duties;

• ability to maintain compliance with the exchange rules of the NYSE MKT LLC;

• the adoption of new accounting standards or changes in interpretations of accounting principles;

• adverse weather conditions or natural disaster, including those which may be related to climate change;

• technological changes in manufacturing, wholesaling, or retailing;

• the risk, including costs and timely delivery issues associated therewith, that information technology systems changes may disrupt our supply chain or operations and could impact cash flow and liquidity, and ability to upgrade information technology infrastructure and other risks associated with the systems that operate our online retail operations; and

• the risk of failure to protect the integrity and security of our information systems and customers' information.

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

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PART I

Item 1. Business

Unless the context requires otherwise, all references in the Annual Report on Form 10-K to the "Company," "Registrant," "we," "us," and "our" refer to American Apparel, Inc., a Delaware Corporation, together with its direct and indirect subsidiaries on a consolidated basis.

Overview

We are a vertically-integrated manufacturer, distributor, and retailer of branded fashion basic apparel and accessories for women, men, children and babies. We are based in downtown Los Angeles, California. As of March 13, 2015, we had approximately 10,000 employees and operated 239 retail stores in 20 countries. We operate a global e-commerce site that serves over 50 countries worldwide at www.americanapparel.com.

We operate a leading wholesale business that supplies high quality T-shirts and other casual wear to distributors and screen printers. We were founded in 1998. In 2003, we opened our first retail store in Los Angeles, California. 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, and Europe. All of our retail stores sell our apparel products directly to consumers.

Because we manufacture domestically and are vertically integrated, we believe this enables us to more quickly respond to customer demand and changing fashion trends and to closely monitor product quality. Our products are noted for quality and fit, and together with our distinctive branding, these attributes have differentiated our products in the marketplace.

All of our trademarks, service marks, and certain other trademarks have been either registered or the subject of pending trademark applications with the U.S. Patent and Trademark Office and the registries of many foreign countries, and/or are protected by common law. In the U.S., we are the registered owner of the "American Apparel®," "Classic Girl®," "Standard American®," "Classic Baby®," and "Sustainable Edition®" trademarks, among others. We have licensed certain logos and designs from third-parties for use in products featuring those logos and designs, but there is no material licensed intellectual property.

Core Business Strengths

We have relied on various core business strengths that have contributed to our past success and will contribute to our future growth.

Quality

We pride ourselves on our quality fabrics and quality garment construction. We have an active quality control department that oversees our in-house knitting facilities, outside knitting contractors who work under our strict specifications, and cutting, sewing, dyeing and finishing facilities in the Los Angeles area. 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.

Design Vision

Our design vision and aesthetic are intended to appeal to young and metropolitan adults by providing them with a core line of iconic and timeless styles that are offered year-round in a wide variety of colors at reasonable prices. Since our founding, we have operated with the belief that there is a large potential market among young adults for well-designed and high-quality fashion essentials.

Speed to Market

With our manufacturing and other business processes centered in downtown Los Angeles, California, our vertically-integrated business model 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. Our wholesale operations are able to fulfill orders of any size with quick turn-around, which allows us to capture business. The ability to swiftly respond to the market means that our retail operations can deliver on-trend apparel in a timely manner and maximize sales of popular styles by replenishing product that would have otherwise sold out.

Advertising and Branding

We attract customers through internally-developed, edgy, high-impact, and 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. Retail stores are an important part

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of our branding and convey a modern and 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.

Broad Appeal

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

Business Strategy

Throughout 2014 and into early 2015, we have brought on a new board of directors and hired new senior management including Paula Schneider, Chief Executive Officer ("CEO"), Hassan Natha, Chief Financial Officer ("CFO"), and Chelsea Grayson, General Counsel as well as other additions to the management team. Together, our new board of directors and new management team are focused on implementing a turnaround strategy and enhancing our corporate governance policies and practices. We have started implementing additional operational and financial processes and disciplines to improve liquidity and profitability. To that end, we have added new members to our executive team in the areas of planning and forecasting, operations, marketing and e-commerce. We have also added members to our legal and human resources departments and have introduced a new code of ethics which we ask all of our new and current employees to read. We believe that a strong operational and financial discipline along with a robust corporate governance structure is an important element of our long-term business strategy.

In addition to enhancing and ensuring compliance with our corporate governance policies, over the next year, we will also be focused on strengthening business fundamentals to create a stable platform for future growth. We believe the following elements enhance our core business strengths and will contribute to the success of our business strategy.

Merchandising

As we have expanded beyond our original product offering of T-shirts, we have increased the variety of products available to our customers such as denim, shoes, sweaters, jackets and accessories. We recently embarked on a study of our current merchandise offerings and are analyzing which categories contribute the most to the value of our company and brand. We intend to streamline our assortment so that we can focus on making those items that our customers really want. By deepening our focus on these core products, we believe we can assure better availability of popular items during peak demand and improve the in-store experience of our customers.

Additionally, a more streamlined offering will also give us improved capacity to experiment with new style introductions, produce short runs of these new styles at lower incremental costs, and conduct robust testing of market acceptance for these new designs. We intend to continue to judiciously introduce new merchandise to complement our existing products in order to attract new customers and increase the frequency of customer visits and the size of customer purchases.

Retail Stores Strategy

Our long-term growth strategy and the success of our business depend in part on an effective management of our global retail stores portfolio and the operation of these stores in a cost-efficient manner. Although we have always actively monitored store performance, we have recently begun a more formal study of our retail stores portfolio in order to identify underperforming stores that should be exited, unfavorable store leases that should be discontinued or renegotiated, as well as stores or geographical areas that will benefit from further investments. We believe that this study will enhance our long-term growth strategy to judiciously open new stores in desirable locations on favorable terms that meet our financial targets. Over the long term, we plan to expand our presence in the U.S. and increase our store footprint in markets throughout Europe and Asia.

We evaluate potential store sites based on traffic patterns, co-tenancies, average sales per square foot achieved by neighboring stores, lease economics, store contribution margin projections, demographic characteristics and other factors considered important regarding the specific location.

Online Sales Strategy

Our online store presence represents a growth opportunity with the potential to increase not only online sales but also in-store sales. Improvements to the online shopping experience have contributed to our financial growth. In order to

remain competitive, we intend to continue refining our online stores with improved functionality, personalized offers, increased service levels and visually optimized content. In 2014, we enhanced the functionality of our online stores in Korea, Mexico and Brazil. We continue to open new online stores in additional countries and in late 2014, launched a new online store in China. We also intend to invest in targeted marketing and advertisement that will enhance our online presence. We have recently brought on new senior management whose responsibility will be to focus on this strategically important aspect of our business.

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