

AMERICAN APPAREL, INC
Form 10-K/A
August 13, 2009
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K/A

Amendment No. 1

(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, 2008

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 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, 2008 was approximately \$463,614,047 based upon the closing price of the common stock on such date as reported by the American Stock Exchange (now the NYSE Amex).

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The number of shares of the registrant's common stock outstanding as of March 12, 2009 was 71,033,757.

DOCUMENTS INCORPORATED BY REFERENCE

Part III of this Annual Report incorporates information by reference from the registrant's definitive Proxy Statement for its Annual Meeting of Stockholders that was filed with the SEC on April 29, 2009.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Amendment No.1 to our Annual Report on Form 10-K/A for the year ended December 31, 2008, 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 Amendment No.1 to our 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, estimate, 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, continue, remain, 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 Amendment No.1 to our 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 in this Amendment No.1 to our Annual Report on Form 10-K/A, those contained under the heading, "Risk Factors," contained in Item 1A of American Apparel, Inc.'s Annual Report on Form 10-K for the year ended December 31, 2008 which was originally filed with the United States Securities and Exchange Commission (the "SEC") on March 16, 2009, as well as in other reports and documents we file with the SEC and include, without limitation, the following:

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

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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;

disruptions in the global financial markets;

increasing competition;

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

suitable store locations and our ability to attract customers to our stores;

effectively carrying out and managing our growth strategy;

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

fluctuations in comparable store sales and margins;

seasonality;

costs of materials and labor;

location of our facilities in the same geographic area;

manufacturing, supply or distribution difficulties or disruptions;

risks of financial nonperformance by customers;

investigations, enforcement actions and litigation;

compliance with or changes in laws and regulations;

costs as a result of operating as a public company;

material weaknesses in internal controls;

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interest rate and foreign currency risks;

loss of U.S. import protections or changes in duties, tariffs and quotas and other risks associated with international business;

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

general economic and industry conditions, including worsening U.S. and foreign economic conditions and turmoil in the financial markets.

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

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American Apparel, Inc.

ANNUAL REPORT ON FORM 10-K/A

FOR THE YEAR ENDED DECEMBER 31, 2008

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EXPLANATORY NOTE REGARDING RESTATEMENT

This Amendment No.1 to our Annual Report on Form 10-K for the year ended December 31, 2008, (this Amendment,) amends our Annual Report on Form 10-K for the fiscal year ended December 31, 2008, (the Original Filing,) that was filed with the SEC on March 16, 2009, to reflect reclassified amounts and revised disclosure of the Company's consolidated financial statements for the fiscal year ended December 31, 2008.

On July 23, 2009, the Company announced that the Audit Committee of the Board of Directors determined that the Company will need to restate its previously issued consolidated financial statements for the year ended December 31, 2008 in order to reclassify its revolving credit facility as a current liability. As a result, the Company determined that because of the pending restatement the annual consolidated financial statements for Company's fiscal year ended December 31, 2008 should no longer be relied upon.

Management reviewed the accounting for the classification of the revolving line of credit under the credit agreement entered into on July 2, 2007 (the BofA Credit Agreement), including the application of Emerging Issues Task Force (EITF) 95-22, Balance Sheet Classification of Borrowings Outstanding under Revolving Credit Agreements That Include both a Subjective Acceleration Clause and a Lock-Box Arrangement and Statement of Financial Accounting Standards No. 6, Classification of Short-Term Obligations Expected to Be Refinanced. Management and the Audit Committee of the Board of Directors has concluded that a portion of the outstanding revolving line of credit balance as of December 31, 2008 should be classified as a current liability. As a result, we are restating our historical consolidated balance sheet as of December 31, 2008. See Note 20 in the Notes to Consolidated Financial Statements included in this Amendment for a discussion of the corrections and a reconciliation of amounts previously reported to those shown herein. Management and the Audit Committee have discussed these matters with Marcum LLP, the Company's independent registered public accounting firm through April 2, 2009.

The Amendment does not set forth the Original Filing in its entirety and includes only the Items affected by the change in classification of the revolving credit facility to a current liability. The following portions of the Original Filing are being amended by the Amendment:

Part II, Item 6	Selected Financial Data
Part II, Item 7	Management's Discussion and Analysis of Financial Condition and Results of Operations
Part II, Item 8	Financial Statements and Supplementary Data
Part II, Item 9A	Controls and Procedures
Part IV, Item 15	Exhibits and Financial Statement Schedules

As required by Rule 12b-15 promulgated under the Securities and Exchange Act of 1934, as amended, this Amendment includes currently dated certifications from the Company's Chief Executive Officer and Chief Financial Officer, as required by Sections 302 and 906 of the Sarbanes-Oxley Act of 2002, as well as the currently dated consent of our independent registered public accounting firm. The certifications of the company's Chief Executive Officer and Chief Financial Officer are attached to the Amendment as Exhibits 31.1, 31.2, 32.1 and 32.2. The consent of our independent public accounting firm is attached to the Amendment as Exhibit 23. The changes we have made are a result of and reflect the reclassification described herein.

No other information in the original Filing has been amended or modified hereby, except for the amended or restated information described above, this Amendment has not been updated since the date of the Original Filing. Events occurring after the date of the Original Filing or other disclosures necessary to reflect subsequent events have been or will be addressed in other reports filed with the SEC subsequent to the date of the Original Filing.

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The following table summarizes certain selected consolidated financial data, which should be read in conjunction with our consolidated financial statements and Notes thereto and with Management's Discussion and Analysis of Financial Condition and Results of Operations included elsewhere in this Amendment. Historical results are not necessarily indicative of the results to be expected in the future. The information presented in the following tables has been adjusted to reflect the restatement of our financial results, which is more fully described in the Explanatory Note Regarding Restatement immediately preceding Part II, Item 6 and in Note 20, Restatement of Previously Issued Consolidated Balance Sheet in the Notes to Consolidated Financial Statements of this Amendment.

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 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.

Other than as included in this Amendment, we have not amended our previously-filed Annual Report on Form 10-K for the period affected by this restatement. The financial information that has been previously filed or otherwise reported for the period is superseded by the information in this Amendment, and the financial information contained in such previously-filed reports should no longer be relied upon.

	Year Ended December 31,				
	2008 (5)	2007	2006	2005	2004 (unaudited)
(In Thousands Except Per Share Data)					
Selected Statement of Operations Data:					
Net sales	\$ 545,050	\$ 387,044	\$ 284,966	\$ 201,450	\$ 133,824
Gross profit	\$ 299,115	\$ 215,473	\$ 145,636	\$ 101,688	\$ 56,334
Income from Operations	\$ 36,064	\$ 31,122	\$ 10,572	\$ 10,782	\$ 9,477
Net Income (Loss)	\$ 14,112	\$ 15,478	\$ (1,606)	\$ 3,487	\$ 6,223
Pro forma Net Income conversion to C Corporation for tax purposes (unaudited)	n/a	\$ 9,457	\$ 257	\$ 3,121	\$ 5,727
Cash Distributions/Dividends Paid (1)	\$	\$ 22,147	\$ 696	\$ 1,793	\$ 1,906
Per Share Data (2)					
Net Earnings (Loss) per share basic	.20	.32	(.03)	.07	.13
Net Earnings (Loss) per share diluted	.20	.31	(.03)	.07	.13
Pro forma Net Earnings per share conversion to C Corporation for tax purposes (unaudited) basic (3)	n/a	.19	.01	.06	.12
Pro forma Net Earnings per share conversion to C Corporation for tax (unaudited) purposes diluted (3)	n/a	.19	.01	.06	.12
Weighted average number of shares basic	69,490	48,890	48,390	48,390	48,390
Weighted average number of shares diluted	70,317	49,414	48,390	48,390	48,390
Dividends Paid (1)	\$.00	\$.45	\$.01	\$.04	\$.04
Balance Sheet Data (4)					
Total Assets	\$ 333,005	\$ 233,350	\$ 163,056	\$ 124,226	\$ 90,367
Working Capital	\$ 79,736	\$ 2,120	\$ 38,559	\$ 40,880	\$ 20,164
Total Long Term Debt Less Current Maturities	\$ 72,328	\$ 10,744	\$ 75,546	\$ 65,365	\$ 2,703
Stockholders' Equity	\$ 136,412	\$ 61,821	\$ 12,973	\$ 14,918	\$ 13,339

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- (1) Dividends paid represent cash dividends paid by Old American Apparel to its stockholders prior to becoming a public company. The Company does not anticipate paying any cash dividends in the foreseeable future.
- (2) See Note 3 (Earnings per share) for an explanation of how earnings per share is calculated.
- (3) See Note 3 (Income Taxes) for an explanation of the pro forma presentation.
- (4) See Note 2 (Completed Merger) for an explanation of the impact of the reverse merger with Endeavor Acquisition Corp.
- (5) Certain amounts have been reclassified as discussed in Note 20, Restatement of Previously Issued Consolidated Balance Sheet in the Notes to Consolidated Financial Statements included elsewhere herein.

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

The discussion and analysis set forth below in this Item 7 has been amended to reflect the reclassification as described in the Explanatory Note Regarding Restatement in this Amendment and in Note 20 of the Notes to Consolidated Financial Statements included elsewhere in this Amendment. For this reason, the data set forth in this section may not be comparable to discussions and data in our previously filed Annual Reports. Refer to Note 20 for additional information including the impact of the restatement for the restated period included in this filing.

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 Amendment or in the Original Filing.

Background

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 6, 2007, with 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 the Company 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. (See Note 2 to the Consolidated Financial Statements for further details.)

Overview

The Company designs, manufactures and sells fashion apparel for women, men, children and pets. The Company sells its products through its retail stores and through its wholesale operations, which include online consumer operations, throughout the U.S. and internationally. American Apparel's revenue is driven by its ability to design and market desirable products by identifying new business opportunities, securing new distribution channels, and renewing and revitalizing existing distribution channels.

Nature of Operations

American Apparel is a vertically-integrated manufacturer, distributor, and retailer of branded fashion basic apparel. As of December 31, 2008, American Apparel operated 260 retail stores in 19 countries. American Apparel also operates a leading wholesale business that supplies t-shirts and other casual wear to distributors and screen printers.

American Apparel conducts its primary manufacturing operations out of an 800,000 square foot facility in the warehouse district of downtown Los Angeles, California. The facility houses its executive offices, as well as the Company's cutting, sewing, warehousing, and distribution operations. In addition, the Company operates

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knitting facilities in Los Angeles and Garden Grove, California, where it makes about one third of the fabric the Company uses in manufacturing. The Company also does most of its dyeing and finishing in-house. Company owned dye houses dye approximately 80% of the raw fabric the Company uses in its manufacturing operations. To supplement the Company's in-house production capacity in December 2007, the Company acquired a new sewing, dyeing, and finishing facility in South Gate, California, which began operations in 2008. This facility has capacity for sewing, dyeing and finishing garments. In May 2008, the Company acquired the facility in Garden Grove, California, which has knitting, dyeing and sewing capacity and began operations in June 2008.

Because the Company's manufacturing process is domestic and vertically integrated, the Company is able to quickly respond to customer demand, react quickly to changing fashion trends, and closely monitor quality. The Company's products are noted for their quality and fit, and the Company's distinctive branding has differentiated it in the marketplace.

The business reporting segments of the Company are U.S. Wholesale, U.S. Retail, Canada, and International. The Company believes this method of segment reporting reflects both the way its business segments are managed and the way each segment's performance is evaluated. The U.S. Wholesale segment includes the Company's wholesale operations in the U.S. and its online consumer operations in the U.S. The U.S. Retail segment includes the Company's retail operations in the U.S. The Canada business segment includes retail, wholesale, and online operations in Canada. The International segment includes retail, wholesale, and online operations outside of the U.S. and Canada. The results of the respective business segments exclude corporate expenses, which consist of the shared overhead costs of the Company. These costs are presented separately and generally include, among other things, the following corporate costs: information technology, human resources, accounting and finance, executive compensation and legal. In the fourth quarter of 2008, the Company implemented and recorded a full year impact from changes to its intercompany transfer pricing policy which will significantly reduce the overall effective tax rate on our international earnings. While the application of our updated intercompany transfer pricing policy did not change our revenue or operating performance on a consolidated basis, it impacted the allocation of operating profit amongst our U.S. Wholesale, Canada and International segments in 2008 when compared to prior years. Financial information about each segment, together with certain geographical information, for the fiscal years ended December 31, 2008, 2007 and 2006 are included under Note 18 to the Consolidated Financial Statements contained herein.

As of December 31, 2008, the U.S. Retail segment consisted of 148 retail stores in the United States and the U.S. Wholesale segment consisted of wholesale operations and online operations. As of December 31, 2008, the Canada segment consisted of 37 stores along with wholesale operations while the International segment consisted of 75 retail stores in 17 countries, online storefronts, and 12 overseas wholesale operations. The International segment consisted of the Company's business in the United Kingdom, Austria, Belgium, France, Germany, Italy, the Netherlands, Spain, Sweden, Switzerland, Israel, Australia, Brazil, Mexico, Japan, South Korea and China.

In 2008, 29.8% of American Apparel's net revenue was generated from U.S. Wholesale operations, 31.0% from U.S. Retail operations, 12.3% from Canada operations and 26.9% from International operations. In 2007, 37.3% of American Apparel's net revenue was generated from U.S. Wholesale operations, 29.9% from U.S. Retail operations, 11.0% from Canada operations and 21.8% from International operations. In 2006, 44.8% of American Apparel's net revenue was generated from U.S. Wholesale operations, 28.2% from U.S. Retail operations, 10.7% from Canada operations and 16.3% from International operations. Total net revenues for 2008, 2007 and 2006 were \$545 million, \$387 million and \$285 million, respectively, and total net earnings (loss) for 2008, 2007, and 2006 were \$14.1 million, \$15.5 million, and (\$1.6) million respectively.

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During the period from January 1, 2006 through December 31, 2008, American Apparel increased its U.S.-based retail stores from 66 to 148, increased its Canada based stores from 20 to 37 and increased its International stores from 17 to 75 in 17 countries. The following tables detail the growth in retail store activity during the years ended December 31, 2008, 2007 and 2006.

	Year Ended December 31, 2008	Year Ended December 31, 2007	Year Ended December 31, 2006
Retail Stores U.S. Retail Segment			
Open at beginning of the period	105	93	66
Opened during the period	44	13	29
Closed during the period	(1)	(1)	(2)
Open at end of the period	148	105	93

	Year Ended December 31, 2008	Year Ended December 31, 2007	Year Ended December 31, 2006
Retail Stores Canada Segment			
Open at beginning of the period	30	26	20
Opened during the period	8	5	6
Closed during the period	(1)	(1)	0
Open at end of the period	37	30	26

	Year Ended December 31, 2008	Year Ended December 31, 2007	Year Ended December 31, 2006
Retail Stores International Retail Segment (excluding Canada)			
Open at beginning of the period	47	28	17
Opened during the period	29	20	11
Closed during the period	(1)	(1)	0
Open at end of the period	75	47	28

Comparable Store Sales

Comparable store sales are defined as the percentage change in sales for stores that have been open for more than twelve months. The table below shows the comparable store sales of American Apparel, by quarter for the years ended December 31, 2008, 2007 and 2006, including the number of stores included in the comparison at the end of each period and the increase from the prior comparable period.

	March 31	For the Quarter Ended			Year to date
		June 30	September 30	December 31	
2006	16%	0%	3%	5%	5%
Number of Stores	43	50	64	83	
2007	17%	24%	27%	40%	29%
Number of Stores	104	119	131	138	
2008	36%	23%	24%	11%	22%
Number of Stores	140	145	149	162	

Executive Summary

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For the year ended December 31, 2008, the Company reported net sales of \$545.0 million, an increase of \$158.0 million, or 40.8%, over the \$387.0 million reported for the year ended December 31, 2007. The increase in net sales was primarily the result of expansion in the U.S. Wholesale and U.S. Retail distribution channels, the Canada retail distribution channel and the International retail distribution channel, as the Company added new store locations and expanded its product offering in existing stores. The Company selects new store locations

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based upon consideration of a number of factors, including projected sales potential, financial requirements of the prospective lease agreement, co-tenancy, as well as ancillary benefits such as increase in brand recognition. Since the beginning of 2007, the Company has been expanding its fabric offerings which facilitated introduction of new styles across the wholesale and retail distribution channels. As many as thirty new styles were added to the retail distribution channel of which the most notable was the addition of denim products. Comparable store sales increased 22% for the year ended December 31, 2008 as compared to the year ended December 31, 2007.

Gross margin for the Company decreased to 54.9% in the year ended December 31, 2008 compared to 55.7% for the year ended December 31, 2007. The decrease in gross profit was primarily the result of 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 award in cost of sales. The \$13.2 million of expenses related to the stock award reduced our gross profit percentage by 2.4%. Excluding the impact of the aforementioned expenses related to the stock award, our gross profit percentage increased to 57.3% in the year ended December 31, 2008 from 55.7% for the year ended December 31, 2007. This increase in gross profit percentage was primarily attributable to an increase in the sales mix during 2008 which included a higher amount of retail sales from the expansion of the U.S. Retail, Canada and International segments which generate higher gross margins than the Company's U.S. Wholesale segment. The gross margin was also favorably impacted from a reduction in inventory reserves of \$1.7 million which increased the gross margin by 0.3% during the year ended December 31, 2008. The reduction in the inventory reserve was primarily the result of the opening of seven new closeout stores in key markets and expansion of certain existing closeout stores to increase inventory selection. Popular styles among the Company's slow-moving stock were actively merchandized in these closeout stores which specialize in selling certain inventory at discounted prices, resulting in higher inventory turnover of potentially slow-moving inventory.

During the year ended December 31, 2008, the Company hired a significant number of new manufacturing employees to support the anticipated increase in demand for the Company's products throughout the remainder of the year and in the future. Related to this activity, the Company incurred additional recruiting and training costs. Based on the Company's prior experience with hiring new employees, it is expected that the productivity of new employees reaches a normalized level within 90-120 days of the date of hire. Typically, gross margins in the U.S. wholesale segment have been negatively impacted during periods where the Company has undergone an increased level of hiring.

As of April 1, 2008, the Company successfully completed the first phase of the implementation of an Enterprise Resources Planning (ERP) system. This first phase included the conversion of the Company's systems for manufacturing and warehouse operations, inventory management and control and wholesale operations. Direct costs incurred in the implementation during the year ended December 31, 2008 were \$2.2 million. In addition, certain indirect costs and inefficiencies related to the changeover of various system components had a minor negative impact upon the results of operations in 2008. Nonetheless, going forward, the improvements in operating information and control systems are expected to be substantial. Since April 1, 2008, the Company has entered the second phase of the implementation, which will include the financial accounting and control systems for the Company's U.S. Wholesale operations. The second phase is scheduled to be completed in the second quarter of 2009.

The Company's net income for the year ended December 31, 2008 decreased to \$14.1 million compared to \$15.5 million for the year ended December 31, 2007. The decrease in net income during the year ended December 31, 2008 was primarily the result of the stock award to the Company's manufacturing employees in August 2008, offset by continued expansion of the Company's operations in the U.S. Retail, Canada and International segments.

Management of the Company believes that its revenue growth has been enhanced by the addition of new stores, increased online sales, and by an increased focus on building brand awareness and product diversity. This increased focus is designed to keep existing retail customers and to attract new retail customers. To build on this

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trend in retail revenue growth, the Company is looking to grow its U.S. Retail segment, and the retail portion of its International and Canada segments. As of February 28, 2009, the Company had signed leases for an additional 9 store locations expected to open in 2009. Additionally, the Company is currently selecting, negotiating and reviewing additional new store locations in both domestic and foreign markets.

As the Company's business grows, management continues to evaluate its existing systems. It is expected that the new ERP system will enable the Company to purchase more efficiently, as well as manage the supply chain and inventory more efficiently. The Company, while currently able to meet its production requirements using both internal and third party resources, is developing strategies to increase its internal production capacity to meet future needs.

Critical Accounting Estimates and Policies

Complete descriptions of American Apparel's significant accounting policies are outlined in Note 3 of the *Notes to Consolidated Financial Statements* included 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. American Apparel's critical accounting estimates and policies include:

sales returns and other allowances;

allowance for doubtful accounts;

inventory valuation;

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;

share-based compensation; and

accruals for the outcome of current litigation.

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. American Apparel's 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 American Apparel's consolidated results of operations or financial condition.

Revenue Recognition

The Company recognizes product sales revenue when title and risk of loss have transferred to the customer, there is persuasive evidence of an arrangement, shipment and passage of title has occurred, the sales price is fixed or determinable and collectability is reasonably assured. Revenue from wholesale product sales is recorded at the time the product is shipped to the customer. Revenue from online sales is recorded at the time the products

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are delivered to the customers. With respect to its retail store operations, the Company recognizes revenue upon the sale of its products to retail customers. The Company's net sales represent gross sales invoiced to customers, less certain related charges for discounts, returns, and other promotional allowances and are recorded 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).

The Company recognizes the sales from gift cards, gift certificates and store credits as they are redeemed for merchandise. Prior to redemption, the Company maintains an unearned revenue liability for gift cards, gift certificates and store credits until the Company is released from such liability. The Company's gift cards, gift certificates and store credits do not have expiration dates.

Sales Returns and Allowances

The Company analyzes sales returns in accordance with Statement of Financial Accounting Standards (SFAS) No. 48 "Revenue Recognition When Right of Return Exists" (SFAS 48). The Company is able to make reasonable and reliable estimates of product returns for its wholesale, online product sales and retail store sales based upon historical experience. The Company also monitors the buying patterns of the end-users of its products based on sales data received by its 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, the Company believes 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 the Company's allowance for sales returns above. However, the Company believes that there would be no significant difference in the amounts reported using other reasonable assumptions than what was used to arrive at the allowance. The Company regularly reviews the factors that influence its estimates and, if necessary, makes adjustments when it believes that actual product returns and credits may differ from established reserves. Actual experience may be significantly different than the Company's 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 that the Company had established, the Company would record a reduction or increase to net revenues in the period in which it made such determination.

Trade Receivables

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

The Company performs on-going credit evaluations of its customers and adjusts credit limits based upon payment history and the customer's current credit worthiness, as determined by the review of their current credit information. Collections and payments from customers are continuously monitored. The Company maintains 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, the Company cannot guarantee that it will continue to experience the same credit loss rates that it has 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. The Company identifies potentially excess and slow-moving inventories by evaluating turn rates, inventory levels and other factors. Excess quantities are identified through evaluation of inventory aging,

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review of inventory turns and historical sales experiences. At times however, the Company 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 of the year. At such times, the Company will consider the timing of inventory buildup in order to determine whether the buildup warrants additional reserves for inventory obsolescence. If the inventory buildup precedes 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 management's estimate of this provision. The Company has evaluated the current level of inventories considering historical sales and other factors and, based on this evaluation, has 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 overheads to the costs of conversion is based on the normal capacity of the Company's 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. The Company determines its normal capacity based upon the amount of direct labor minutes in a reporting period.

During 2008, the Company opened seven closeout stores in key markets and expanded certain existing closeout stores to increase their available inventory for sale. Popular styles among the Company's slow-moving stock were actively merchandized in these closeout stores which specialize in selling certain inventory at discounted prices, resulting in higher inventory turnover of potentially excess and slow-moving inventory. The impact of this sales increase in our closeout stores was the primary result of a net reduction of \$1.7 million to the Company's reserve for excess and slow-moving inventory at December 31, 2008.

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 SFAS No. 142, *Goodwill and Other Intangible Assets* (SFAS 142). The SFAS 142 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. The Company estimates 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.

Long-Lived Assets

The Company periodically reviews the values assigned to long-lived assets, such as property and equipment, intangibles and goodwill. The associated depreciation and amortization periods are reviewed on an annual basis.

Impairment of Long-Lived Assets

The Company follows the provisions of SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (SFAS 144). SFAS 144 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.

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The Company considers 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 American Apparel's overall strategy with respect to the manner or use of the acquired assets or changes in American Apparel's 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.

The Company evaluates acquired assets and its 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 the Company to conclude that impairment indicators exist, and therefore that goodwill and other intangible assets as well as other long lived assets are impaired. Such evaluations for impairment 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 year ended December 31, 2008, the Company recorded an impairment charge in the amount of \$0.6 million related to underperforming retail stores located in each of the U.S. Retail, Canada and International segments.

Foreign Currency

In preparing the 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 the Company disposes of subsidiaries, then any cumulative translation gains or losses would be recorded into the statement of operations. If the Company determines 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, the Company considers the relevant subsidiary's local currency to be the functional currency for each of its foreign subsidiaries.

Income Taxes

The Company records the estimated future tax effects of temporary differences between the tax basis of assets and liabilities and amounts reported in the accompanying consolidated balance sheets, as well as tax credit carrybacks and carryforwards. The Company periodically reviews the recoverability of deferred tax assets recorded on the balance sheet and provides 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, the Company operates within multiple taxing jurisdictions and is subject to audit in these jurisdictions. In management's opinion, adequate provisions for

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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.

Contingencies

The Company is subject to proceedings, lawsuits and other claims related to various matters. The Company assesses 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. The Company currently does not believe, based upon information available at this time, that these matters will have a material adverse effect on its 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, results of operations or cash flows. See Note 16 and 19 to the Company's Consolidated Financial Statements.

Share-Based Compensation

The Company intends to use stock options and other stock-based awards to reward long-term performance. The Company believes that providing a meaningful portion of an executive's total compensation package in stock options and other stock-based awards will align the incentives of its executives with the interests of stockholders and with the Company's long-term success. The Company expects the compensation committee and Board to develop their equity award determinations based on their judgments as to whether the complete compensation packages provided to executives, sufficient to retain, motivate and adequately reward the executives.

Any such equity awards will be granted through the 2007 Performance Equity Plan, which was adopted by the Company's Board and was approved by the stockholders. The 2007 Performance Equity Plan reserves 11.0 million shares of common stock for issuance in accordance with its terms. All employees, directors, officers and consultants will be eligible to participate in the 2007 Performance Equity Plan. The material terms of the 2007 Performance Equity Plan are further described in the section of the definitive proxy statement entitled "2007 Performance Equity Plan Proposal" filed with the SEC on November 28, 2007. On April 17, 2008, approximately 0.03 million shares of common stock having an aggregate value of \$0.4 million were granted to seven non-employee directors in connection with the closing of the Acquisition. The value of the stock award was based upon the December 12, 2007 closing price per share of \$15.60. On August 14, 2008, approximately 1.9 million shares of common stock having an aggregate value of \$12.1 million were awarded to eligible manufacturing employees. Of the \$12.1 million, \$5.2 million was withheld for payment of employment and withholding taxes, approximately 1.1 million shares with an aggregate value of \$6.9 million were issued to employees and cash was paid to employees in lieu of the issuance of fractional shares. The value of the stock award was based upon the August 14, 2008 closing price per share of \$6.54. As of December 31, 2008, the Company has not granted any stock awards under the 2007 Performance Equity Plan, other than the awards as described above. For further information regarding such grants, also see "Equity Compensation Plan Information" under Item 5 of the Original Filing.

Table of Contents**Year Ended December 31, 2008 compared to Year Ended December 31, 2007****American Apparel, Inc.****Consolidated Statements of Operations****For the Year Ended, 2008 and 2007****(Dollars in Thousands)**

	Year Ended December 31, 2008 (audited)		Year Ended December 31, 2007 (audited)	
Net sales	\$ 545,050	100.0%	\$ 387,044	100.0%
Cost of sales	245,935	45.1%	171,571	44.3%
Gross profit	299,115	54.9%	215,473	55.7%
Operating expenses	263,051	48.3%	184,351	47.6%
INCOME FROM OPERATIONS	36,064	6.6%	31,122	8.0%
INTEREST AND OTHER (INCOME) EXPENSE				
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%

Net Sales: The following table sets forth American Apparel's net sales for the year ended December 31, 2008 as compared to December 31, 2007 and provides key breakdowns within each segment of net sales growth from period to period. Net Sales were as follows:

	Year Ended December 31, 2008		Year Ended December 31, 2007 (Dollars in Thousands)		\$ Change	% Change
	Amount	%	Amount	%	Amount	%
NET SALES	\$ 545,050	100.0%	\$ 387,044	100.0%	\$ 158,006	40.8%

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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%
	\$ 545,050	100.0%	\$ 387,044	100.0%	\$ 158,006	40.8%

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 1 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 1 store was closed. Additionally, during the same period 44 retail stores were opened and 1

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retail store was closed in our U.S. Retail business segment. Also of primary significance to the expansion of American Apparel's retail business in the U.S. was the Company's 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 American Apparel's 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, the Company continued its increase in production in order to meet customer demand during the peak sales season.

U.S. Retail: Net sales for the 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 the 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 the 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 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, the Company 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 45.1% and 44.3% 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 42.7% 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

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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 the Company's in-house production capacity in December 2007, the Company 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 the Company's production process. The new facility began production in January 2008 and will further enhance the Company's 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, the Company 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 the Company's in-house production capacity, in May 2008, the Company 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 the Company added knitting capacity. The facility was formerly a contract dyeing vendor for the Company, and operations were not interrupted by the acquisition.

Gross Profit: Gross profit percentage decreased from 55.7% of net sales for the year ended December 31, 2007 to 54.9% 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. 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 55.7% for the year ended December 31, 2007 to 57.3% 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. This benefit was partially offset by the hiring of a significant number of new manufacturing employees to support increased production.

Operating Expenses: The following table sets forth American Apparel's operating expenses for the year ended December 31, 2008 as compared to December 31, 2007 (dollars in thousands).

	Year Ended December 31, 2008		Year Ended December 31, 2007		\$ Change Amount	% Change
	Amount	%	Amount	%		
OPERATING EXPENSES	\$ 263,051	100%	\$ 184,351	100%	\$ 78,700	42.7%
Selling	168,516	64.1%	115,602	62.7%	52,914	45.8%
Warehouse and Distribution	15,606	5.9%	10,663	5.8%	4,943	46.4%
General and Administrative	78,929	30.0%	58,086	31.5%	20,843	35.9%
	263,051	100%	184,351	100%	78,700	

Operating Expenses: Operating expenses increased from \$184.4 million for the year ended December 31, 2007 to \$263.1 million for the year ended December 31, 2008, an increase of \$78.7 million or 42.7%. Operating expenses include:

Selling: 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 the Company's products throughout all of its segments.

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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 the Company's 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. The Company also increased compensation to certain valued employees, as the Company believes that it must provide competitive compensation opportunities so that it can 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: 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: General and administrative expenses for the year ended December 31, 2008 were \$78.9 million, as compared to \$58.1 million for the year ended December 31, 2007, an increase of \$20.8 million or 35.9%. General and administrative expenses represented 14.5% and 15.0% of total net sales for the years ended December 31, 2008 and 2007, respectively.

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 the company's 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.

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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. The Company 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 the Company's 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 Taxes: 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.

Where applicable, state income taxes are provided by American Apparel at the applicable statutory rates multiplied by pre-tax income. American Apparel and its subsidiaries file income tax returns in various states and foreign jurisdictions.

Net Income: The Company's 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**Year Ended December 31, 2007 compared to Year Ended December 31, 2006****American Apparel, Inc.****Consolidated Statements of Operations****For the Year Ended, 2007 and 2006****(Dollars in Thousands)**

	Year Ended December 31, 2007 (audited)		Year Ended December 31, 2006 (audited)	
Net sales	\$ 387,044	100.0%	\$ 284,966	100.0%
Cost of sales	171,571	44.3%	139,330	48.9%
Gross profit	215,473	55.7%	145,636	51.1%
Operating expenses	184,351	47.6%	135,064	47.4%
INCOME FROM OPERATIONS	31,122	8.0%	10,572	3.7%
INTEREST AND OTHER (INCOME) EXPENSE				
Interest expense	17,541	4.5%	11,812	4.1%
Foreign currency transaction gain	(722)	(0.2)%	(601)	(0.2)%
Other Income	(980)	(0.3)%	(607)	(0.2)%
INCOME (LOSS) BEFORE INCOME TAXES	15,283	3.9%	(32)	0.0%
Income tax (benefit) provision	(195)	(0.1)%	1,574	0.6%
NET INCOME (LOSS)	\$ 15,478	4.0%	\$ (1,606)	(0.6)%

Pro forma Computation Related to Conversion to C Corporation for income tax purposes (unaudited):

	For the years ended December 31, (Dollars in thousands)			
	2007		2006	
Historical income (loss) before taxes	\$ 15,283	3.9%	\$ (32)	0.0%
Pro forma provision (benefit) for income taxes	5,826	1.5%	(289)	0.0%
Pro forma income	\$ 9,457	2.4%	\$ 257	0.0%

Net Sales: The following table sets forth American Apparel's net sales for the year ended December 31, 2007 as compared to December 31, 2006 and provides key breakdowns within each segment of net sales growth from period to period. Net Sales were as follows:

Year Ended December 31, 2007		Year Ended December 31, 2006 (Dollars in Thousands)		\$	%
Amount	%	Amount	%	Change	Change
				Amount	%

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NET SALES	\$ 387,044	100.0%	\$ 284,966	100.0%	102,078	35.8%
U.S. Wholesale	144,478	37.3%	127,761	44.8%	16,717	13.1%
U.S. Retail	115,615	29.9%	80,210	28.2%	35,405	44.1%
Canada	42,407	11.0%	30,570	10.7%	11,837	38.7%
International	84,544	21.8%	46,425	16.3%	38,119	82.1%
	\$ 387,044	100.0%	\$ 284,966	100.0%	\$ 102,078	

One significant factor contributing to the overall growth in net sales period to period was the expansion of our international operations, as evidenced by the opening of 20 international retail stores with 1 store closing

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during the year ended December 31, 2007. In our Canada segment, during the year ended December 31, 2007, 5 retail stores were opened and 1 store was closed. Additionally, during the same period 13 retail stores were opened and 1 retail store was closed in our U.S. Retail business segment. Also of primary significance to the expansion of American Apparel's retail business in the U.S. was the Company's increased focus on building brand awareness and targeted advertising campaigns as further described below.

Net Sales increased \$102.1 million, or 35.8% from \$284.9 million for the year ended December 31, 2006 to \$387.0 million for the year ended December 31, 2007.

U.S. Wholesale: Net sales for American Apparel's U.S. Wholesale segment increased \$16.7 million, or 13.1%, for the year ended December 31, 2007 as compared to the year ended December 31, 2006, primarily as a result of an increase in online sales due to strategic advertising and increased brand recognition, as well as organic growth of the wholesale business. 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 2007, compared to 2006, the Company went through a phase of increased production in order to meet customer demand during the peak sales season. Online sales increased from \$9.2 million in 2006 to \$18.9 million in 2007, an increase of \$9.7 million.

U.S. Retail: Net sales for the U.S. Retail segment increased \$35.4 million, or 44.1%, for the year ended December 31, 2007 as compared to the year ended December 31, 2006, fueled by the addition of retail stores in key markets within the U.S. in 2007, as well as a 26.2% increase in comparable store sales in 2007 compared to 2006. 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, 2007, the number of open stores was 105, while as of December 31, 2006, the number of open stores was 93.

Canada: Net sales for the Canada segment increased \$11.8 million, or 38.7%, for the year ended December 31, 2007 as compared to the year ended December 31, 2006, as a result of the addition of retail stores in key markets within Canada, as well as a 26.3% increase in same store sales in 2007 compared to 2006. Canada wholesale sales decreased to \$11,335 in 2007 from \$13,097 in 2006 for a total decrease of \$1,762 or 19.6%. This decrease can be attributed to our increased efforts to expand our wholesale clientele. As of December 31, 2007, the number of open stores was 30, while as of December 31, 2006, the number of open stores was 26.

International: Net sales for the International segment increased \$38.1 million, or 82.1%, in the year ended December 31, 2007 as compared to the year ended December 31, 2006. This increase was primarily due to the net increase of 19 international stores opened from 28 in 2006 to 47 in 2007 and partially due to a 35.5% increase in same store sales in 2007 compared to 2006. In the year ended December 31, 2007, American Apparel opened six additional stores in Germany, five in the United Kingdom, two each in Korea and France, and one each in Italy, Japan, Israel, Netherlands and Sweden and closed one store in Korea. During the year ended December 31, 2007, approximately 12.6 million and \$6.6 million of the international sales were generated by wholesale and online sales, respectively, compared with \$6.2 million and \$2.8 million in sales for wholesale and online sales, respectively, for the year ended December 31, 2006.

Cost of Sales: Cost of sales decreased as a percentage of net sales from 48.9% in the year ended December 31, 2006 to 44.3% in the year ended December 31, 2007. Decrease in cost of sales as a percentage of net sales was primarily related to increases in retail sales which have a higher margin. Decrease in the cost of sales is also a result of better operational efficiencies realized through production during the year ended December 31, 2007. During that period American Apparel was operating closer to its normal production capacity, with lower overtime costs, and better capacity utilization.

Gross Profit: Gross profit increased from \$145.6 million for the year ended December 31, 2006 to \$215.5 million for the year ended December 31, 2007, which represents an increase of 48.0%. The overall increase in gross profit is a result of growth in retail sales which realize higher margins. This increase in gross profit is also a result of an increased amount of sales being generated from the International segments and the portion of the

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U.S. Wholesale segment related to online sales. In the International segment, there was growth in International online sales and the addition of new retail stores contributed to sales which generated higher margins.

Operating Expenses: The following table sets forth American Apparel's operating expenses for the year ended December 31, 2007 as compared to December 31, 2006 (dollars in thousands).

	Year Ended December 31, 2007		Year Ended December 31, 2006		\$ Change Amount	% Change
	Amount	%	Amount	%		
OPERATING EXPENSES	\$ 184,351	100%	\$ 135,064	100%	\$ 49,287	36.5%
Selling	115,602	62.7%	83,957	62.2%	31,645	37.7%
Warehouse and Distribution	10,663	5.8%	9,721	7.2%	942	9.7%
General and Administrative	58,086	31.5%	41,386	30.6%	16,700	40.4%
	\$ 184,351	100%	\$ 135,064	100%	\$ 49,287	

Operating Expenses: Operating expenses increased from \$135.1 million to \$184.4 million for the year ended December 31, 2007, which represents an increase of 36.5%. Operating expenses include:

Selling: Selling expenses together with unallocated corporate selling, advertising and promotion expenses, for the year ended December 31, 2007 were \$115.6 million, which represented 29.8% of net sales, as compared to \$84.0 million the year ended December 31, 2006, which represented 29.5% of net sales.

Increases in selling expenses are primarily due to the increase in worldwide retail stores as well as the strategic promotional advertising of the Company's brands and product styles throughout all of its segments. The net increase in selling expenses is attributable to the following: Advertising costs increased \$5.3 million mainly due to the expenses incurred to promote new store openings and to strategically promote the Company's product styles through print ads, magazines and online media. Payroll costs increased \$16.1 million as a result of increased staffing levels to support new store openings. Opened stores increased from 147 in 2006 to 182 in 2007, driving an increase in rent and occupancy costs of \$7.7 million. Expenses for store maintenance and store supplies increased \$2.5 million, due to Company expansion driven by new store openings and as a result of new lease agreements entered into for new stores.

Warehouse and Distribution: Warehouse and distribution expenses for the year ended December 31, 2007 as compared to the year ended December 31, 2006 increased by \$0.9 million. These expenses represented 2.7% and 3.4%, respectively of the total net sales for 2007 and 2006. Increase in international warehouse and distribution expenses is primarily due to an increase in transportation costs (such as import fees, duties and carrier costs of \$0.3 million) to distribute the merchandise to international subsidiaries and an increased number of international locations where merchandise is shipped. The increase in warehouse and distribution expense is also attributable to increases of \$0.4 million in staffing necessary to support increased volume and sales growth, with the remaining \$0.2 million in warehouse & distribution expense increase due to other miscellaneous expense increases.

General and Administrative: General and administrative expenses of the segments for the year ended December 31, 2007 were \$58.1 million, as compared to \$41.4 million for the year ended December 31, 2006, an increase of \$16.7 million, or 40.4%. General and Administrative expenses represented 15.0% and 14.5% of total net sales for the years ended December 31, 2007 and 2006, respectively.

The U.S. Wholesale segment's general and administrative expenses increased in 2007 primarily due to higher levels of staffing necessary to support the expansion of American Apparel. The increase in the general and administrative expenses was primarily due to the additional staffing and administrative structure required to support a higher number of retail locations, depreciation and amortization costs increased due to buildouts of leasehold improvements and additions of information systems equipment required to support the growth in wholesale, retail and online distribution channels. In total, there was a \$2.6 million increase in

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staffing expenses, a \$3.1 million increase in depreciation and amortization, an increase of \$3.7 million in professional fees, an increase in management fees of \$3.7 million, a \$0.9 million increase in repair and maintenance costs, and a \$2.5 million increase in bonuses paid. The remainder of the increases is due to changes in miscellaneous expenses.

Interest Expense: The major components of interest expense in 2007 were interest on the outstanding revolving credit facility, loans from related and unrelated parties and a term loan from a private investment firm. American Apparel increased its levels of debt in 2007 primarily in order to finance its expansion and buildout of retail stores opened during the period. Financing was also used to purchase additional manufacturing and information systems equipment required to support higher manufacturing to support increased sales in all segments. Interest rates on debt ranged from 4.6% to 24% during the year ended December 31, 2007. Interest expense for the year ended December 31, 2007 was \$17.5 million as compared to \$11.8 million for the year ended December 31, 2006. These expenses represented 4.5% and 4.1%, respectively, of the total net sales for 2007 and 2006. The net increase in interest expense is attributable to the increase in interest bearing debt. There was no significant change in the effective interest rate. Total interest bearing debt increased from \$94.9 million at December 31, 2006 to \$114.1 million at December 31, 2007.

Other Income: Other income for the year ended December 31, 2007 as compared to the year ended December 31, 2006 increased by \$0.4 million. Other income represented (0.3)% of the total net sales for 2007 and (0.2%) for 2006. The increase in other income is primarily due to rebates received from environmental fees (as a result of a Company-wide environmentally-friendly waste recycling program), as well as miscellaneous insurance recoveries.

Income Taxes: Income tax (benefit) provision decreased from \$1.6 million for the year ended December 31, 2006 to \$(0.2) million for the year ended December 31, 2007.

Prior to July 1, 2004, the Company 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 the Company's stockholders. The S Corporation Election terminated with the consummation of the Acquisition on December 12, 2007. As a result of the Company's conversion from the 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. This resulted in a deferred tax benefit of \$6.2 million being recognized and included in the 2007 tax (benefit) provision.

Where applicable, state income taxes are provided by American Apparel at the applicable statutory rates multiplied by pre-tax income. American Apparel and its subsidiaries file income tax returns in various states and foreign jurisdictions.

Net Income (Loss): American Apparel's net income (loss) after income taxes for the year ended December 31, 2006 as compared to the year ended December 31, 2007 were (\$1.6) million and \$15.5 million, respectively. A significant factor contributing to the increase in American Apparel's net income after income taxes from 2006 to 2007 was a significant increase in net sales, combined with the reduction in cost of sales as a percentage of net sales, and recognition of a deferred tax benefit as a result of the conversion from S Corporation to a C Corporation.

On a pro forma basis, for 2007, conversion to a C Corporation resulted in income before taxes of \$15.2 million. Pro forma net income for 2007 was \$9.4 million.

Liquidity and Capital Resources

Over the past year, the Company's growth has been funded through a combination of borrowings from related and unrelated parties, bank debt and lease financing.

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As of December 31, 2008, the Company had (i) approximately \$11.4 million in unrestricted cash, (ii) \$12.1 million available and \$49.4 million outstanding under the BofA Credit Agreement, and (iii) \$51.0 million of borrowings outstanding under its credit agreement, dated January 18, 2007, with SOF (the SOF Credit Agreement). See Debt Agreements below for an overview of the BofA Credit Agreement, the SOF Credit Agreement and the Company's other debt agreements.

Although the BofA Credit Agreement expires on July 2, 2012 and the Company has the intent and believes it will have the ability to maintain this debt outstanding for more than one year, the Company has classified its borrowings under the facility as a current liability in accordance with the provisions set forth in Emerging Issues Task Force (EITF) 95-22, Balance Sheet Classifications, Borrowings Outstanding Under Revolving Credit Agreements that include both a Subjective Acceleration Clause and a Lock-Box Arrangement. Accordingly, the borrowings under the BofA Credit Agreement represent short-term borrowings and are presented as a current liability net of amounts refinanced under the Lion Credit Agreement on March 13, 2009, as described below, of \$15,974 that was previously outstanding under the BofA Credit Agreement and such amounts will continue to be classified as a long-term liability as of December 31, 2008 in accordance with SFAS No. 6. These short-term borrowings were previously reported as long-term debt, amounting to \$32,938 at December 31, 2008.

On March 13, 2009, American Apparel entered into a Credit Agreement (the Lion Credit Agreement) among the Company, in its capacity as Borrower, certain subsidiaries of the Company, in their capacity as Facility Guarantors, Lion Capital LLP, in its capacity as administrative agent and collateral agent, Lion, as Initial Lender (in such capacity, the Initial Lender), and the other lenders from time to time party thereto (together with the Initial Lender, the Second Lien Lenders). Pursuant to the Lion Credit Agreement, the Initial Lender made term loans to the Company in an aggregate principal amount equal to \$80 million, of which \$5 million constitute a fee paid by the Company to Lion Capital LLP in connection with the Lion Credit Agreement. A portion of the proceeds of the loans made under the Lion Credit Agreement was used by the Company to repay in full all outstanding amounts due and owing under the SOF Credit Agreement. The remaining proceeds were used to reduce the outstanding revolver balance under the BofA Credit Agreement, to repay \$3.25 million of loans owed by the Company to Dov Charney, and to pay fees and expenses related to the transaction. In connection with the loans under the Lion Credit Agreement, the Company issued to Lion a seven-year warrant, which is exercisable at any time during its term, to purchase an aggregate of 16 million shares of the Company's common stock at an exercise price of \$2.00 per share, which exercise price is subject to adjustment under certain circumstances. The Lion Warrant may be exercised by Lion by paying the exercise price in cash, pursuant to cashless exercise of the Lion Warrant or by a combination of the two methods. As a result of financing obtained from Lion the Company believes that it currently has sufficient cash and financing commitments to meet its funding requirements through December 2009.

In connection with the financing from Lion, the Company also entered into an amendment to the BofA Credit Agreement to, among other things: (i) consent to the Lion Credit Agreement, (ii) permit certain repayments of the promissory notes due to Dov Charney, and (iii) fix the maturity date at July 2, 2012.

On December 19, 2008, in connection with an amendment to the BofA Credit Agreement, Dov Charney loaned the Company \$2.5 million in exchange for a promissory note. On February 10, 2009, Dov Charney loaned the Company an additional \$4.0 million in exchange for a promissory note. The promissory notes were to mature in January 2013 and provided for interest at an annual rate of 6%, payable in kind. The promissory notes were repaid in an aggregate amount equal to \$3.25 million with a portion of the proceeds of the loans under the Lion Credit Agreement.

On December 19, 2008, in connection with an amendment to the SOF Credit Agreement, the Company issued the SOF Warrant, which expires on December 19, 2013 and is exercisable at any time during its term. This amendment to the SOF Credit Agreement, among other things, extended the maturity date of the SOF Credit Agreement from January 18, 2009 to April 20, 2009.

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On August 14, 2008, approximately 1.9 million shares of Company common stock having an aggregate value of \$12.1 million were awarded to eligible manufacturing employees. Of the \$12.1 million, \$5.2 million was withheld for payment of employment and withholding taxes and approximately 1.1 million shares with an aggregate value of \$6.9 million were issued to employees and cash was paid to employees in lieu of the issuance of fractional shares. The value of the stock award was based upon the August 14, 2008 closing price per share of \$6.54 (date of grant).

On April 17, 2008, the Company issued 33,656 shares of Company common stock having an aggregate value of \$0.4 million were granted to seven non-employee directors in connection with the closing of the Acquisition. The value of the stock award was based upon the December 12, 2007 closing price per share of \$15.60.

On February 6, 2008 the Company called for redemption of all of the issued and outstanding Endeavor Warrants. Prior to the redemption date of March 7, 2008, approximately 16.2 million of the Endeavor Warrants outstanding at December 31, 2007 were exercised. The remaining 0.01 million Endeavor Warrants were redeemed by the Company at a price of \$.01 per warrant. The net proceeds received by the Company from the Endeavor Warrant exercise amounted to approximately \$65.6 million.

Cash Flow Overview

Year Ended December 31, 2008

For the year ended December 31, 2008, cash provided by operations was \$21.2 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 \$23.7 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 American Apparel's 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, the Company used \$72.1 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 \$14.8 million and an increased investment in property and equipment of \$30.9 million for the U.S. Retail, \$4.7 million in the Canada segment and \$18.3 million in the International segment. In addition, the Company 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 the Company's 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 the Company 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 \$(5.4) 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

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taxes payable of \$3.8 million, offset by the increase in inventory of \$22.2 million, decrease in receivables of \$.05 million, increase in prepaid expenses and other current assets of \$2.3 million, and decrease in accounts payable and accrued expenses of \$7.3 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, American Apparel used \$23.8 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 \$18.5 million for the U.S. retail and other segments. In 2007, American Apparel 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 buy out of Sang Ho Lim, the other stockholder of Old American Apparel prior to the Acquisition, of \$67.9 million, decreases to the line of 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.

Year Ended December 31, 2006

For the year ended December 31, 2006, cash provided by operations was \$7.7 million. This is a result of income from operations before non-cash expenses (primarily depreciation and amortization, inventory reserve and deferred rent expense) of \$16.0 million offset by the increase in inventory of \$13.3 million, decrease in other assets of \$4.6 million and the increase in accounts payable and accrued expenses of \$8.8 million. Cash provided by operations was a direct result of buildup in trade payables due to liquidity issues in late 2006 until additional financing was secured. This financing was completed in January 2007.

For the year ended December 31, 2006, cash used in investing activities was \$16.9 million. This is a result of investments in property and equipment for the wholesale, retail and other segments to support the growth of American Apparel. The retail segment opened 46 new stores during the year ended December 31, 2006. During 2006, American Apparel invested in leasehold improvements to support buildouts and opening of new retail stores.

For the year ended December 31, 2006, cash from financing activities was \$10.2 million. This is a result of increases to the Company's line of credit of \$6.8 million, increases in term loans and notes payable of \$7.6 million offset by payments to term loans and notes payable of \$7.4 million, payments to capital lease obligations of \$3.2 million and distributions and advances to stockholders of \$1.1 million.

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The following is an overview of American Apparel's debt as of December 31, 2008 (dollar amounts in thousands).

Description of Debt	Lender Name	Interest Rate	December 31, 2008	Covenant Violations	Reference
Revolving credit facility	Bank of America	LIBOR + 4.5%	\$ 49,401	No	a
Revolving credit facility (Canada)	Toronto Dominion Bank	Prime + 1.00%	409	Yes	b
Term loan from private investment firm	SOF	16.0%	51,000	No	c
Other			558		
Capital lease obligations	61 individual leases ranging between \$1 \$428	From 6.1% to 17.9%	4,602		d
Subordinated notes payable to related parties		6%	3,292		e
Cash overdraft			2,413		
Total debt			\$ 111,675		

(a) On July 2, 2007, the Company replaced its secured revolving credit facility of \$62,500 with an increased revolving credit facility (the Credit Agreement) of \$75,000 from a new bank (the Bank). The Credit Agreement was to expire on March 21, 2009, the date thirty days prior to the April 20, 2009 maturity date of the loan agreement with SOF Investments L.P. Private IV (SOF), as discussed below, unless the SOF loan was refinanced on terms acceptable to the Bank. The SOF loan was refinanced on March 13, 2009 (see Note 20 to the accompanying consolidated financial statements). As such, the Credit Agreement will now mature on July 2, 2012. Although the Credit Agreement expires on July 2, 2012 and the Company has the intent and believes it will have the ability to maintain this debt outstanding for more than one year, the Company has classified its borrowings under the facility as a current liability in accordance with the provisions set forth in Emerging Issues Task Force (EITF) 95-22, Balance Sheet Classifications, Borrowings Outstanding Under Revolving Credit Agreements that include both a Subjective Acceleration Clause and a Lock-Box Arrangement. Accordingly, the borrowings under the BofA Credit Agreement represent short-term borrowings and are presented as a current liability net of amounts refinanced under the Lion Credit Agreement on March 13, 2009, as described above, of \$15,974 that was previously outstanding under the BofA Credit Agreement and such amounts will continue to be classified as a long-term liability as of December 31, 2008 in accordance with SFAS No. 6. These short-term borrowings were previously reported as long-term debt, amounting to \$32,938 at December 31, 2008.

Borrowings under the Credit Agreement are subject to certain advance provisions established by the Bank and are collateralized by substantially all of the Company's assets. Interest under the agreement is at LIBOR (2.59% at December 31, 2008) plus 4.5% or the Bank's prime rate (which rate can in no event be lower than LIBOR plus 2.5% per annum) (3.25% at December 31, 2008) plus 2.5%, at the Company's option. The average borrowings under the Company's revolving credit facility during the year ended December 31, 2008 were \$51,438.

The Company has amended the Credit Agreement on five occasions to address various matters, most recently on December 19, 2008. As a precondition to the effectiveness of the fifth amendment, Dov Charney, CEO, was required to make a subordinated loan to the Company in the amount of \$2,500 (see Note 11 to the accompanying consolidated financial statements). Significant covenants included in the Credit Agreement, as amended, include limiting the Company's capital expenditures to \$9,262 in the first quarter of 2009 and to approximately \$8,500 for the remainder of 2009. The Company was in compliance with the financial covenants at December 31, 2008.

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(b) At December 31, 2008, the CI Companies had a line of credit with a bank that provided for borrowings up to C\$4,000 due on demand, bearing interest at the bank's prime rate (3.5% at December 31, 2008) plus 1.00% per annum, payable monthly. This line of credit is secured by two \$7,500 moveable hypothecs, which provides for a charge on the CI Companies' accounts receivable, inventory and all other moveable assets and by Section 427 security under the Bank Act of Canada on inventory. The credit agreement contains various covenants which require the CI Companies to maintain certain financial ratios and commitments as defined by the bank. At December 31, 2008, the CI Companies were not in compliance with certain of its covenants. Subsequent to year end, the CI Companies signed a new banking agreement with its bank and the U.S. affiliate has subrogated its note in the amount of \$6,527 in favor of the bank. With this, the CI Companies are in compliance with its bank covenants.

(c) As of December 31, 2008, the Company had a term loan agreement with SOF originally dated January 18, 2007 with a balance of \$41,000, which was subsequently increased to \$51,000 on July 22, 2007. Indebtedness under the agreement bore interest at 16% per annum, payable monthly and was to mature on April 20, 2009. The SOF loan was fully repaid on March 13, 2009 from the proceeds of a term loan with a new lender. The SOF term loan agreement required the Company to meet certain financial covenants. In the event the Company was in default under the agreement, the interest rate increased to 21% per annum and SOF had the right to demand payment in full of all outstanding indebtedness. The SOF term loan was collateralized by substantially all assets of the Company subject to prior liens with respect to any such assets under the Credit Agreement with the Bank. In accordance with SFAS No. 6, Classification of Short-Term Obligations Expected to Be Refinanced, an amendment of ARB No. 43, Chapter 3A, the outstanding loan balance of \$51,000 at December 31, 2008 is reflected as a long-term liability in the accompanying consolidated balance sheet.

The covenants included in the SOF term loan agreement were substantially similar to the covenants included in the Credit Agreement with the Bank (see above). The Company amended the SOF term loan agreement nine times, most recently on December 19, 2008. In connection with the ninth amendment, the Company paid SOF a fee of \$2,550 and issued warrants (the SOF Warrants) to purchase 1,000 shares of Company common stock at an exercise price of \$3.00 per share (see Note 15 of the accompanying consolidated financial statements for a description of the terms and accounting for the SOF Warrants). Under the terms of the ninth amendment, if the Company were to fail to raise \$16 million of financing by March 13, 2009, the Company would be required to issue to SOF warrants to purchase an additional 2,000 shares of Company common stock on the same terms as the SOF Warrants. As discussed above, the SOF loan was repaid on March 13, 2009, and the additional SOF Warrants were not required to be issued.

(d) American Apparel leases certain equipment under capital lease arrangements expiring at various times through 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.

(e) During the year ended December 31, 2008, the Company repaid outstanding loan balances to the Company's Chief Executive Officer (CEO). Loans from the CEO were reduced from \$3,804 and \$2,232 at December 31, 2007 to \$0 and \$792 at December 31, 2008, respectively. Both loans bear interest at 6% commencing December 12, 2007 and were scheduled to mature in 2012. On December 19, 2008, the Company received \$2,500 from the CEO in exchange for a promissory note scheduled to mature in January 2013, which bears interest at 6%, payable in kind. Prior to December 12, 2007, related party loans were non-interest bearing and without terms of repayment. For the years ended December 31, 2008, December 31, 2007 and December 31, 2006, interest of \$346, \$277 and \$157, respectively. For the periods prior to December 12, 2007, interest has been imputed at an average rate of 14% and was credited as an addition to paid-in capital.

Table of Contents**Financial Covenants**

American Apparel's credit arrangements impose certain restrictions on American Apparel regarding capital expenditures and limit American Apparel's ability to: 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. In addition, the BofA Credit Agreement imposes a minimum availability requirement, and the Lion Credit Agreement includes a total debt to consolidated EBITDA ratio financial covenant. Such restrictions could limit American Apparel's ability to respond to market conditions, to provide for unanticipated capital investments or to take advantage of business or acquisition opportunities.

Contractual Obligations Summary

The following table summarizes American Apparel's contractual commitments as of December 31, 2008, which relate to future minimum payments due under non-cancelable licenses, leases, 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 sale and General and administrative expenses in American Apparel's financial statements and amounted to approximately \$59,205 for the year ended December 31, 2008.

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	\$ 87,604	\$	\$ 16,794	\$ 70,810	\$
Current debt and revolving lines of credit, including interest (1)	61,295	61,295			
Capital lease obligations, including interest	5,141	3,011	2,000	130	
Operating lease obligations	390,904	55,343	100,466	89,906	145,189
Advertising commitments	2,439	2,439			
Total	\$ 547,383	\$ 122,088	\$ 119,260	\$ 160,846	\$ 145,189

(1) Includes amounts outstanding on the revolving credit facilities, including \$15,974 of borrowings under the BofA Credit Agreement that were refinanced under the Lion Credit Agreement on March 13, 2009 on a long-term basis.

Over the past year, American Apparel's growth has been funded through a combination of borrowings from related and unrelated parties, bank debt and lease financing. As of December 31, 2008, American Apparel had approximately \$11.4 million in unrestricted cash.

Off-Balance Sheet Arrangements

The Company has no off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on its financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to investors, except for the financing commitments previously discussed.

Inflation

Inflation affects the cost of raw materials, goods and services used by American Apparel. 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 American Apparel cannot precisely determine the effects of inflation on its business, it is management's belief that the effects on revenues and operating

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results have not been significant. American Apparel seeks to mitigate the adverse effects of inflation primarily through improved productivity and strategic buying initiatives. American Apparel does not believe that inflation has had a material impact on its 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.

Accounting Pronouncements-Newly Issued and Adopted

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157 Fair Value Measurements, (SFAS No. 157) which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. The Company has implemented SFAS No. 157 and has determined that the results did not have a material impact on its consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159 The Fair Value Option for Financial Assets and Financial Liabilities including an amendment of FASB Statement No. 115 (SFAS No. 159), which permits entities to choose to measure many financial instruments and certain other items at fair value. The fair value option established by this Statement permits all entities to choose to measure eligible items at fair value at specified election dates. A business entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. The Company has elected not to apply the fair value option of any of its eligible financial instruments. Accordingly, the provisions of SFAS No. 159 did not have a material impact on its consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141R, Business Combinations (SFAS No. 141R), which replaces SFAS No. 141, Business Combinations. SFAS No. 141R establishes principles and requirements for determining how an enterprise recognizes and measures the fair value of certain assets and liabilities acquired in a business combination, including noncontrolling interests, contingent consideration, and certain acquired contingencies. SFAS No. 141R also requires acquisition-related transaction expenses and restructuring costs be expensed as incurred rather than capitalized as a component of the business combination. SFAS No. 141R will be applicable prospectively to business combinations for which the acquisition date is on or after January 1, 2009. SFAS No. 141R would have an impact on accounting for any businesses acquired after the effective date of this pronouncement.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements An Amendment of ARB No. 51 (SFAS No. 160). SFAS No. 160 establishes accounting and reporting standards for the noncontrolling interest in a subsidiary (previously referred to as minority interests). SFAS No. 160 also requires that a retained noncontrolling interest upon the deconsolidation of a subsidiary be initially measured at its fair value. Upon effectiveness of SFAS No. 160, the Company would be required to report any noncontrolling interests as a separate component of consolidated stockholders' equity. The Company would also be required to present any net income allocable to noncontrolling interests and net income attributable to the stockholders of the Company separately in its consolidated statements of operations. SFAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after January 1, 2009. SFAS No. 160 requires retroactive adoption of the presentation and disclosure requirements for existing minority interests. All other requirements of SFAS No. 160 shall be applied prospectively. SFAS No. 160 would have an impact on the presentation and disclosure of the noncontrolling interests of any non wholly-owned businesses acquired in the future.

In February 2008, the FASB issued FSP FAS 157-2, Effective Date of FASB Statement No. 157, which delays the effective date of SFAS No. 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis, with the exception of the application of the statement to non-recurring nonfinancial assets and nonfinancial liabilities. This FSP defers the effective date of SFAS No. 157 to fiscal years beginning after November 15, 2008 and the interim periods

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within those fiscal years for items within the scope of this FSP. The Company has evaluated this new FSP and has determined that it will not have a significant impact on the determination or reporting of our financial results.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Hedging Instruments and Hedging Activities* an amendment of FASB Statement No. 133 (SFAS No. 161). SFAS No. 161, which is effective January 1, 2009, requires enhanced qualitative and quantitative disclosures with respect to derivatives and hedging activities. The Company does not anticipate the adoption of SFAS No. 161 to have a material impact on its consolidated financial statements.

In April 2008, the FASB issued FASB Staff Position SFAS 142-3, *Determination of the Useful Life of Intangible Assets* (FSP SFAS 142-3). FSP SFAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, *Goodwill and Other Intangible Assets* . The objective of this FSP is to improve the consistency between the useful life of a recognized intangible asset under Statement 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS 141R, *Business Combinations*, and other U.S. Generally Accepted Accounting Principles (GAAP). FSP SFAS 142-3 is effective for fiscal years beginning after December 15, 2008. The adoption of FSP SFAS 142-3 is effective January 1, 2009, and is not expected to have a material the impact on the Company s consolidated financial statements.

In June 2008, the FASB ratified the consensus reached by the EITF on Issue No. 07-5, *Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity s Own Stock* (EITF No. 07-5). EITF No. 07-5 provides guidance for determining whether an equity-linked financial instrument (or embedded feature) is indexed to an entity s own stock. EITF No. 07-5 applies to any freestanding financial instrument or embedded feature that has all of the characteristics of a derivative or freestanding instrument that is potentially settled in an entity s own stock. To meet the definition of indexed to own stock, an instrument s contingent exercise provisions must not be based on (a) an observable market, other than the market for the issuer s stock (if applicable), or (b) an observable index, other than an index calculated or measured solely by reference to the issuer s own operations, and the variables that could affect the settlement amount must be inputs to the fair value of a fixed-for-fixed forward or option on equity shares. EITF No. 07-5 is effective for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. The Company will adopt EITF No. 07-5 as of January 1, 2009.

There are no other recently issued accounting pronouncements that are expected to have a material impact on the Company s consolidated financial statements.

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American Apparel, Inc.

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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 sheets of American Apparel, Inc. (the Company) as of December 31, 2008 and 2007, and the related consolidated statements of operations, stockholders' equity and comprehensive income (loss) and cash flows for the years ended December 31, 2008, 2007 and 2006. Our audits also included the financial statement schedule for the years ended December 31, 2008, 2007 and 2006 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 2007, and the consolidated results of its operations and its cash flows for the years ended December 31, 2008, 2007 and 2006 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.

As discussed in Note 20 to the consolidated financial statements, the consolidated balance sheet as of December 31, 2008 has been restated to correct a misstatement.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), American Apparel's internal control over financial reporting as of December 31, 2008, 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 16, 2009, expressed an adverse opinion on the effectiveness of the Company's internal control over financial reporting because of the existence of material weaknesses.

/s/ Marcum LLP

Marcum LLP

(formerly Marcum & Kliegman LLP)

New York, NY

March 16, 2009, except for Note 20 which is dated 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 per share amounts)

December 31, 2008 and 2007

	2008 (As Restated, See Note 20)	2007
ASSETS		
CURRENT ASSETS		
Cash	\$ 11,368	\$ 19,292
Trade accounts receivable, net of allowances of \$1,441 and \$1,876 at December 31, 2008 and 2007, respectively	16,439	16,602
Other receivables	1,438	1,120
Prepaid expenses and other current assets	3,931	4,498
Inventories, net	148,154	106,434
Deferred taxes, current portion	5,628	4,894
Total Current Assets	186,958	152,840
PROPERTY AND EQUIPMENT, net	112,408	64,868
INTANGIBLE ASSETS, net	10,086	2,286
GOODWILL	1,906	950
DEFERRED TAXES	8,444	3,146
OTHER ASSETS	13,203	9,260
TOTAL ASSETS	\$ 333,005	\$ 233,350
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES		
Cash overdraft	\$ 2,413	\$ 2,778
Revolving credit facilities and current portion of long-term debt	34,318	99,930
Accounts payable	32,731	15,451
Accrued expenses	26,289	21,877
Income taxes payable	8,855	7,300
Current portion of capital lease obligations	2,616	3,384
Total Current Liabilities	107,222	150,720
LONG-TERM DEBT, Net of current portion	67,050	642
SUBORDINATED NOTES PAYABLE TO RELATED PARTIES	3,292	6,036
CAPITAL LEASE OBLIGATIONS, net of current portion	1,986	4,066
DEFERRED RENT	17,043	10,065
TOTAL LIABILITIES	196,593	171,529
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS EQUITY		
Preferred stock, \$.0001 par value, authorized 1,000 shares; none issued		
Common stock, \$.0001 par value, authorized 120,000 shares; 72,221 shares issued and 70,787 shares outstanding at December 31, 2008 and 57,595 shares issued and outstanding at December 31, 2007	7	6

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Additional paid-in capital	131,252	57,162
Accumulated other comprehensive (loss) income	(2,703)	865
Retained earnings	17,900	3,788
	146,456	61,821
Less: Treasury stock, 1,434 shares at cost	(10,044)	
TOTAL STOCKHOLDERS EQUITY	136,412	61,821
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	\$ 333,005	\$ 233,350

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

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

(Amounts in Thousands, except per share amounts)

For the Years Ended December 31, 2008, 2007 and 2006

	2008	2007	2006
NET SALES	\$ 545,050	\$ 387,044	\$ 284,966
COST OF SALES (including share-based compensation of \$12,102 for the year ended December 31, 2008)	245,935	171,571	139,330
GROSS PROFIT	299,115	215,473	145,636
OPERATING EXPENSES (including share-based compensation of \$530 for the year ended December 31, 2008 and related party charges of \$619, \$6,111 and \$2,135 for the years ended December 31, 2008, 2007 and 2006, respectively)	263,051	184,351	135,064
INCOME FROM OPERATIONS	36,064	31,122	10,572
INTEREST AND OTHER (INCOME) EXPENSE			
Interest expense (including related party interest expense of \$346, \$1,633 and \$655 for the years ended December 31, 2008, 2007 and 2006, respectively)	13,921	17,541	11,812
Foreign currency transaction loss (gain)	621	(722)	(601)
Other expense (income)	155	(980)	(607)
TOTAL INTEREST AND OTHER EXPENSE	14,697	15,839	10,604
INCOME (LOSS) BEFORE INCOME TAXES	21,367	15,283	(32)
INCOME TAX PROVISION (BENEFIT)	7,255	(195)	1,574
NET INCOME (LOSS)	\$ 14,112	\$ 15,478	\$ (1,606)
Weighted average basic shares outstanding	69,490	48,890	48,390
Weighted average diluted shares outstanding	70,317	49,414	48,390
Basic Earnings (loss) per share	\$ 0.20	\$ 0.32	\$ (0.03)
Diluted Earnings (loss) per share	\$ 0.20	\$ 0.31	\$ (0.03)
PRO FORMA COMPUTATION RELATED TO CONVERSION TO C CORPORATION FOR INCOME TAX PURPOSES (unaudited):			
Historical income (loss) before income taxes		\$ 15,283	\$ (32)
Pro forma provision (benefit) for income taxes		5,826	(289)
Pro forma net income		\$ 9,457	\$ 257
Pro forma Basic Earnings per share		\$ 0.19	\$ 0.01
Pro forma Diluted Earnings per share		\$ 0.19	\$ 0.01

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

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American Apparel, Inc. and Subsidiaries

Consolidated Statements of Stockholders Equity and Comprehensive Income (Loss)

(Amounts in Thousands)

For the Years Ended December 31, 2008, 2007 and 2006

	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)
BALANCE, January 1, 2006	48,390	\$ 5	\$	\$ 5,920	\$	(114)	\$ 9,265	\$ 14,918	
Advances to stockholders					(395)			(395)	
Distributions to stockholders							(696)	(696)	
Imputed interest on stockholder loans				277				277	
Net loss							(1,606)	(1,606)	\$ (1,606)
Foreign currency translation						475		475	475
BALANCE, December 31, 2006	48,390	5		6,197	(553)	361	6,963	12,973	\$ (1,131)
Outstanding shares of the Registrant at time of reverse merger dated 12/12/07	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						504		504	504
BALANCE, December 31, 2007	57,595	6		57,162		865	3,788	61,821	\$ 15,982
Exercise of Warrants	13,521	1		65,617				65,618	
Purchase 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						(3,568)		(3,568)	(3,568)

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**BALANCE, December 31,
2008**

72,221 \$ 7 \$ (10,044) \$ 131,252 \$ \$ (2,703) \$ 17,900 \$ 136,412 \$ 10,544

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

Table of Contents**American Apparel, Inc. and Subsidiaries****Consolidated Statements of Cash Flows****(Dollars in Thousands)****For the Years ended December 31, 2008, 2007, and 2006**

	2008	2007	2006
CASH FLOWS FROM OPERATING ACTIVITIES			
Cash received from customers	\$ 544,062	\$ 386,931	\$ 284,678
Cash paid to suppliers, employees and others	(499,184)	(372,595)	(266,262)
Income taxes paid	(11,351)	(3,247)	(1,019)
Interest paid	(12,194)	(17,533)	(10,338)
Other	(162)	1,006	611
Net cash provided by (used in) operating activities	21,171	(5,438)	7,670
CASH FLOWS USED IN INVESTING ACTIVITIES			
Capital expenditures	(68,650)	(22,195)	(16,890)
Purchase of net assets under business acquisition	(3,500)	(1,600)	
Net cash used in investing activities	(72,150)	(23,795)	(16,890)
CASH FLOWS FROM FINANCING ACTIVITIES			
Cash overdraft from financial institution, net	(288)	(1,212)	(590)
Borrowings (repayments) under revolving credit facilities, net	1,381	(2,659)	6,753
Deferred financing costs paid	(4,139)	(1,630)	
Advances to stockholders, net		(21,594)	(1,091)
Proceeds from exercise of Warrants	65,619	1,200	
Purchase of treasury stock	(10,044)		
Repurchase of common stock for payment of payroll 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 notes payable to related party	2,500	4,732	5,445
Repayment of notes payable to related parties		(6,804)	(813)
Borrowings under notes payable to unrelated parties	966	2,118	4,406
Repayment under notes payable to unrelated parties	(1,336)	(8,288)	(1,088)
(Repayments of) borrowings under subordinated note payable to related party	(4,580)	(360)	180
(Repayment of) borrowing under subordinated note payable to unrelated party		(14,201)	
Borrowings under term loans and notes payable		51,386	7,637
Repayment of term loans and notes payable		(8,685)	(7,385)
Repayment of capital lease obligations	(3,734)	(3,567)	(3,215)
Net cash provided by financing activities	41,171	44,530	10,239
EFFECT OF FOREIGN EXCHANGE RATE ON CASH	1,884	215	168
NET (DECREASE) INCREASE IN CASH	(7,924)	15,512	1,187
CASH, beginning of period	19,292	3,780	2,593

CASH, end of period	\$ 11,368	\$ 19,292	\$ 3,780
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Table of Contents**American Apparel, Inc. and Subsidiaries****Consolidated Statements of Cash Flows (Continued)**

(Dollars in Thousands)

For the Years ended December 31, 2008, 2007, and 2006

	2008	2007	2006
RECONCILIATION OF NET INCOME (LOSS) TO NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES			
Net income (loss)	\$ 14,112	\$ 15,478	\$ (1,606)
Depreciation and amortization	20,844	13,306	10,904
Imputed interest on stockholder loans		577	277
Stock-based compensation	12,625		
Impairment charge	644	252	252
Foreign currency transaction loss (gain)	621	(722)	(601)
Inventory (recovery) reserve	(1,731)	537	4,012
Bad debt expense (recovery)	598	(313)	1,077
Deferred taxes	(6,212)	(6,913)	(456)
Deferred rent	7,746	2,594	2,094
Changes in cash due to changes in operating assets and liabilities			
Trade accounts receivables	(816)	(499)	(93)
Other receivables	(374)		
Inventories	(44,630)	(22,158)	(13,311)
Prepaid expenses and other current assets	(2)	(2,298)	(160)
Other assets	(8,053)	(1,714)	(4,616)
Accounts payable	17,482	(15,835)	10,084
Accrued expenses	6,196	8,503	(1,290)
Income taxes payable	2,121	3,767	1,103
Net cash provided by (used in) operating activities	\$ 21,171	\$ (5,438)	\$ 7,670
NON-CASH INVESTING AND FINANCING ACTIVITIES			
Property and equipment acquired under capital leases	\$ 1,092	\$ 4,614	\$ 2,156
Liabilities assumed under Endeavor Acquisition		1,411	
Reclassification of advances to stockholders		553	
Issuance of warrants to lender	1,021		

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

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American Apparel, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(Dollar and Shares in Thousands, except per share amounts)

For the Years Ended December 31, 2008, 2007 and 2006

NOTE 1 Organization and Business

American Apparel, Inc. (the Registrant) was incorporated in Delaware on July 22, 2005 as Endeavor Acquisition Corporation, a blank check company formed to serve as a vehicle for the acquisition of an operating business. The Registration Statement for the Registrant's initial public offering (Offering) was declared effective December 15, 2005. The Registrant consummated the Offering on December 21, 2005 and received net proceeds of approximately \$113,500. In January 2006, the underwriter exercised the overallotment option generating an additional \$8,840 of net proceeds. Substantially all of the net proceeds of the Offering were intended to be generally applied toward consummating a business combination with an operating company. American Apparel (defined below) was subsequently identified as this operating company.

On December 18, 2006, the Registrant entered into an agreement and plan of reorganization (Agreement) by which it ultimately acquired American Apparel. On November 6, 2007, the Registrant entered into an amended Acquisition Agreement (Amended Agreement) with American Apparel whereby American Apparel, Inc. (AA), American Apparel Canada Wholesale Inc. and American Apparel Canada Retail Inc. (collectively CI Companies) became wholly owned subsidiaries of the Registrant. Upon the completion of the merger with AA and CI Companies on December 12, 2007, the Registrant changed its name to American Apparel, Inc. AA and CI Companies are collectively referred to as American Apparel and the consolidated entity, including the Registrant, is collectively referred to as the Company. For accounting purposes, this business combination (Merger) has been treated as a reverse merger.

The Company is a vertically-integrated manufacturer, distributor, and retailer of fashion essentials for men, women and children. The Company sells its products through a wholesale distribution channel supplying t-shirts and other casual wear to distributors and screen printers, as well as direct to customers through retail stores located in the United States and internationally. In addition, the Company operates an online retail e-commerce website.

NOTE 2 Completed Merger

Dov Charney, a 50% owner of AA's common stock and 100% owner of CI Companies' common stock and current Chief Executive Officer of the Company received from the Registrant 37,258 shares of its common stock in exchange for his ownership interest in AA and CI Companies. The other 50% owner of AA'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 (the Closing), the Registrant 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 AA'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.

At the Closing, 8,064 shares of the Company's common stock issued to Dov Charney were placed in escrow until the later of (a) December 12, 2008, the date of the first anniversary of the Closing and (b) the thirtieth day after the date that the Company files its Annual Report on Form 10-K for the year ended December 31, 2007 (which report was filed March 17, 2008), as a fund for the payment of indemnification claims that may be made

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by the Company as a result of any breaches of AA's covenants, representations and warranties in the Agreement and certain lawsuits to which AA is a party. The Company's right to bring a claim for indemnification expired on December 12, 2008 and those shares are no longer subject to the escrow.

Pursuant to the Agreement, the Company and Dov Charney entered into a registration rights agreement to provide Dov Charney certain rights relating to the registration of shares of the Company's common stock that he received in connection with the Merger. Under the registration rights agreement, Dov Charney is afforded both demand and piggyback registration rights.

Basis of Presentation and Accounting Treatment of the Merger

The Merger has been accounted for as a reverse merger and recapitalization, since the majority stockholder of American Apparel owns a majority of the outstanding shares of the common stock of the Company immediately following the completion of the Merger. American Apparel is the accounting acquirer and, consequently, the Merger is treated as a recapitalization of American Apparel. Accordingly, the assets and liabilities and the historical operations that are reflected in these consolidated financial statements are those of American Apparel and are recorded at the historical cost basis of American Apparel. The Registrant's assets and liabilities are consolidated as of December 12, 2007 and are recorded at their net tangible book value; the Registrant's results of operations are consolidated with American Apparel commencing December 12, 2007.

Additionally, AA and CI Companies have been under common control since each of the entities' inception. In conjunction with the Merger, the two entities were consolidated in a manner similar to a pooling of interests. Accordingly, AA and CI Companies were consolidated retroactively to the earliest period presented, using the historical cost basis of each entity.

In the consolidated statement of stockholders' equity, in addition to reflecting the common control merger retroactive to the earliest period presented, the recapitalization of the number of shares of common stock attributable to the American Apparel stockholders is also reflected retroactive to the earliest period presented. Accordingly, the number of shares presented as outstanding as of the earliest period presented total 48,390, consisting of the 37,258 issued to Dov Charney, and the 11,132 equivalent number of shares assigned to Sang Ho Lim. Sang Ho Lim's shares were determined by dividing the \$67,903 (\$121,589/19,933) he received in cash by the \$6.10 net tangible book value per share of the Registrant as of the Closing. These shares were also used to calculate the Company's earnings (loss) per share for all periods prior to the Merger.

NOTE 3 Summary of Significant Accounting Policies

Liquidity Matters

Over the past year, the Company's growth has been funded through a combination of borrowings from related and unrelated parties, bank debt and lease financing.

As of December 31, 2008, the Company had (i) approximately \$11.4 million in unrestricted cash, (ii) \$12.1 million available and \$49.4 million outstanding under the revolving credit facility, dated July 2, 2007, with Bank of America, N.A. and the lenders party thereto (the "BofA Credit Agreement"), and (iii) \$51.0 million of borrowings outstanding under its credit agreement, dated January 18, 2007, with SOF Investments, L.P. Private IV ("SOF") and, such credit agreement, the "SOF Credit Agreement"). See Note 10 Long-term Debt.

On March 13, 2009, the Company and Lion Capital LLP ("Lion") entered into (i) a Credit Agreement (the "Lion Credit Agreement") among the Company, in its capacity as Borrower, certain subsidiaries of the Company, in their capacity as Facility Guarantors, Lion Capital LLP, in its capacity as administrative agent and collateral agent, Lion Capital (Guernsey) II Limited ("Lion"), as Initial Lender, and the other lenders from time to time

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party thereto, and an Investment Agreement (the "Investment Agreement") between the Company and Lion. Pursuant to the Lion Credit Agreement, Lion made term loans to the Company in an aggregate principal amount

equal to \$80,000, of which \$5,000 of such loan constitutes a fee paid by the Company upon the terms and conditions set forth in the Lion Credit Agreement. The Company used a portion of the proceeds of the financing to repay in full the outstanding amount under the SOF Credit Agreement. The remaining portion of the proceeds were used to repay a portion of the promissory notes due to Dov Charney, the Company's Chairman of the Board of Directors, Chief Executive Officer and President, as described below, to reduce the outstanding revolver balance under the BofA Credit Agreement, and to pay fees related to the transaction. Pursuant to the Investment Agreement, the Company issued to Lion a seven-year warrant (the "Lion Warrant"), which is exercisable at any time during its term, to purchase an aggregate of 16,000 shares of the Company's common stock at an exercise price of \$2 per share upon the terms and conditions set forth in the Investment Agreement.

Principles of Consolidation and Basis of Presentation

The consolidated financial statements include the accounts of American Apparel, Inc. and its direct and indirect wholly-owned subsidiaries (see Note 1). All intercompany accounts and transactions have been eliminated upon consolidation.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted 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 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. The most significant estimates include: sales returns and other allowances, allowance for doubtful accounts, inventory valuation and obsolescence, valuation and recoverability of long-lived intangible assets including the values assigned to acquired intangible assets, goodwill, property and equipment, income taxes; valuation of warrants; and accruals for the outcome of current litigation.

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 could differ from those estimates.

Earnings per Share

The Company presents earnings per share ("EPS") in accordance with Statement of Financial Accounting Standards ("SFAS") No. 128, "Earnings Per Share." SFAS No. 128 requires dual presentation of basic and diluted EPS. Basic EPS includes no dilution and is computed by dividing net income (loss) available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted EPS includes the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock.

The effect of the Merger has been given retroactive application in the EPS calculation (see Note 2, "Basis of Presentation and Accounting Treatment of the Merger"). The common stock issued and outstanding with respect to the pre-Merger stockholders of the Registrant has been included in the EPS calculation since the Closing date of the Merger. All of the Registrant'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.

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The impact of one million shares of common stock underlying the SOF Warrant (Note 10) is excluded from the EPS calculation because the effect would be anti-dilutive. The impact of the 16,000 shares of common stock underlying the Lion Warrant are also not included because the Lion Warrant was issued after December 31, 2008

The following provides a reconciliation of information used in calculating EPS for the years ended December 31, 2008, 2007 and 2006:

	2008	2007	2006
Weighted average shares outstanding used in Basic EPS	69,490	48,890	48,390
Dilutive effect of warrants and underwriters purchase option	827	524	
Weighted average shares outstanding for Diluted EPS	70,317	49,414	48,390

Share-Based Compensation

On December 12, 2007, the stockholders approved the 2007 Performance Equity Plan (the 2007 Plan). The 2007 Plan authorizes the granting of awards, the exercise of which would allow up to an aggregate of 7,710 shares of the Company s common stock to be acquired by the holders of such awards. The purpose of the 2007 Plan is to enable the Company s compensation committee to offer its employees, officers, directors and consultants whose past, present and/or potential contributions to the Company have been, are or will be important to the success of the Company, an opportunity to acquire a proprietary interest in the Company. The 2007 Plan provides for various types of incentive awards including: incentive stock options, non-qualifying stock options, restricted stock and stock appreciation rights. The 2007 Plan will enable the compensation committee to determine virtually all terms of each grant, which will allow the Company to respond to changes in compensation practices, tax laws, accounting regulations and the size and diversity of its business. On November 20, 2008, the stockholders approved an amendment to the 2007 Plan to (i) increase the number of shares of common stock reserved for issuance thereunder by 3,290 shares and (ii) to increase the maximum number of shares of common stock that may be granted as awards thereunder to any one individual in any one calendar year from 200 to 2,500.

In accordance with SFAS No. 123(R), Share-Based Payment (SFAS No. 123(R)) all stock-based compensation must be recognized as an expense in the financial statements and that cost be measured at the fair value of the award. SFAS No. 123 (R) also requires that excess tax benefits related to stock option exercises be reflected as financing cash inflows instead of operating cash inflows.

Revenue Recognition

The Company recognizes product sales revenue when title and risk of loss have transferred to the customer, there is persuasive evidence of an arrangement, shipment and passage of title has occurred, the sales price is fixed or determinable and collectability is reasonably assured. Revenue from wholesale product sales are recorded at the time the product is shipped to the customer. Online product sales are recorded at the time the product is received by the customer. With respect to its own retail store operations, the Company recognizes revenue upon the sale of its products to retail customers. The Company s net sales represent gross sales invoiced to customers, less certain related charges for discounts, returns, and other promotional allowances, and is recorded 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 Other Allowances discussed below for further information).

The Company recognizes the sales from gift cards, gift certificates and store credits as they are redeemed for merchandise. Prior to redemption, the Company maintains an unearned revenue liability for gift cards, gift certificates and store credits until the Company is released from such liability. The Company s gift cards, gift certificates and store credits do not have expiration dates. The unearned revenue for gift cards, gift certificates and store credits are recorded in accrued expenses in the amount of \$2,672 and \$1,816 at December 31, 2008 and 2007, respectively.

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Sales Returns and Allowances

Allowances For Sales Returns The Company analyzes sales returns in accordance with SFAS No. 48 Revenue Recognition When Right of Return Exists (SFAS 48). The Company is able to make reasonable and reliable estimates of product returns for its wholesale, online product sales and retail store sales based on the Company's past history. The Company also monitors the buying patterns of the end-users of its products based on sales data received by its 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, the Company believes that its historical returns analysis is an accurate basis for its allowance for sales returns. Actual results could differ from those estimates.

As with any set of assumptions and estimates, there is a range of reasonably likely amounts that may be calculated for each allowance above. However, the Company believes that there would be no significant difference in the amounts reported using other reasonable assumptions than what was used to arrive at each allowance. The Company regularly reviews the factors that influence its estimates and, if necessary, makes adjustments when it believes that actual product returns, credits and other allowances may differ from established reserves. Actual experience associated with any of these items may be significantly different than the Company's estimates.

Concentrations of Credit Risk

Financial instruments which potentially subject the Company to credit risk consist primarily of cash (the amounts of which may, at times, exceed Federal Deposit Insurance Corporation limits on insurable amounts) and trade accounts receivable, relating substantially to the Company's U.S. wholesale segment. The Company mitigates its risk by investing in or through major financial institutions. The Company had approximately \$7,675 and \$5,939 held in foreign banks at December 31, 2008, and 2007, respectively.

The Company performs on-going credit evaluations of its customers and adjusts credit limits based upon payment history and the customer's current credit worthiness, as determined by the review of their current credit information. Collections and payments from customers are continuously monitored. The Company maintains 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, the Company cannot guarantee that it will continue to experience the same credit loss rates that it has 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.

Cash

The Company's cash balances represent unrestricted cash on deposit held at banks.

Trade Accounts Receivable

Accounts receivable primarily consists of trade receivables, including amounts due from credit card companies, net of allowances. Amounts due from credit card, debit card and electronic benefit transfer transactions as of December 31, 2008, and 2007, were approximately \$1,153 and \$1,089, respectively.

Inventories

Inventories are stated at the lower of cost or market. Cost is primarily determined on the first-in, first-out (FIFO) method. The cost elements of inventories include materials, labor and overhead. For the years ended December 31, 2008, 2007, and 2006, respectively, no one supplier provided more than 10% of the Company's raw material purchases.

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The Company identifies potentially 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. The Company provides lower of cost or market reserves for such identified excess and slow-moving inventories. At December 31, 2008 and 2007, the Company had a reserve for slow-moving inventories of \$2,498 and \$4,284, respectively. The Company's reserve for slow-moving inventories decreased \$1,786 for the year ended December 31, 2008.

The Company establishes a reserve for inventory shrinkage for each of its retail locations. The reserve is based on the historical results of physical cycle counts. The Company has a reserve for inventory shrinkage and obsolescence in the amount of \$1,120, \$1,065 and \$528 as of December 31, 2008, 2007 and 2006, respectively.

Property and Equipment

Property and equipment are carried at cost. Depreciation is provided on a straight-line basis over the estimated useful lives of the related assets. The costs of normal maintenance and repairs are charged to expense in the year incurred. Expenditures which significantly improve or extend the life of an asset are capitalized and depreciated over the asset's remaining useful life. Amortization of leasehold improvements is computed using the straight-line method over the shorter of the estimated useful lives of the related assets or the lease term. Upon sale or disposition, the related cost and accumulated depreciation are removed from the accounts and the resulting gain or loss, if any, is reflected in operations.

Goodwill and Other Intangible Assets

Goodwill represents the excess of purchase price over the fair value of identifiable net assets of companies acquired. 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 SFAS No. 142, *Goodwill and Other Intangible Assets* (SFAS 142). The SFAS 142 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. The Company estimates 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. The Company has not had any goodwill impairment.

Other definite lived intangibles are amortized on a straight-line basis over periods not exceeding 10 years.

Impairment of Long-Lived Assets

The Company follows the provisions of SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. SFAS 144 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. For the years ended December 31, 2008, 2007 and 2006, the Company recognized impairment charges of \$644, \$252 and \$252, respectively, on assets to be held and used. The impairment charges related primarily to leasehold improvements and furniture and fixtures for certain North American retail stores and are included in the Consolidated Statements of Operations under the caption *Operating Expenses*.

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Foreign Currency

The financial statements of international subsidiaries are translated into U.S. Dollars using the exchange rate at each balance sheet date for assets and liabilities and an average exchange rate for each period for revenues, expenses, gains and losses. Foreign currency transaction gains and losses are charged or credited to operations as incurred. Where the local currency is the functional currency (which is determined based on management's judgment and involves consideration of all relevant economic facts and circumstances affecting the subsidiary) translation adjustments are recorded as a separate component of stockholders' equity. The Company recognized a foreign currency transaction loss of \$621 in 2008 and foreign currency transaction gains \$722 and \$601 in 2007 and 2006, respectively.

Taxes

As a result of the Merger, AA 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 Company's stockholders. Accordingly, the income taxes were not reflected in the Company'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 Company'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, represents the tax effects that would have been reported had the Company been subject to U.S. federal and state income taxes as a corporation for the years ended December 31, 2007 and 2006. 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 the Company actually been subject to U.S. federal and state income taxes for all periods presented. Therefore, the unaudited pro forma amounts are for informational purposes only and are intended to be indicative of the results of operations had the Company been subject to U.S. federal and state income taxes as a corporation for the years ended December 31, 2007 and 2006.

The Company's foreign domiciled subsidiaries are subject to foreign income taxes on earnings in their respective jurisdictions. The Company elected to have their foreign subsidiaries, except CI Companies, consolidated in their U.S. federal income tax return; the Company will generally be eligible to receive tax credits on its U.S. federal income tax return for most of the foreign taxes paid.

The Company recognizes deferred tax liabilities and assets for the expected future tax consequences of events that have been included in the financial statements or tax returns. Deferred tax liabilities and assets are determined based on the difference between the financial statement and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. The Company estimates the degree to which tax assets and credit carryforwards will result in a benefit based on expected profitability by tax jurisdiction. A valuation allowance for such tax assets and loss carryforwards is provided when it is determined that such assets will more likely than not go unused. If it becomes more likely than not that a tax asset will be used, the related valuation allowance on such assets would be reversed. 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, the Company operates within multiple taxing jurisdictions and is 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.

The Company accounts for the presentation of taxes in accordance with Emerging Issue Task Force (EITF) Issue No. 06-3, How Taxes Collected from Customers and Remitted to Governmental Authorities

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Should Be Presented in the Income Statement (That is, Gross versus Net Presentation) (EITF 06-3). The EITF reached a consensus that the scope of the Issue includes any tax assessed by a governmental authority that is both imposed on and concurrent with a specific revenue-producing transaction between a seller and a customer, and may include, but is not limited to, sales, use, value added, and some excise taxes. The Company currently records its sales net of any value added or sales tax.

Fair Value of Financial Instruments

Financial instruments include cash, trade accounts receivable, other receivables, accounts payable, notes payable and long term debt. The recorded values of cash, trade accounts receivable, other receivables and accounts payable approximate fair value based on their short-term nature. The recorded values of notes payable and long-term debt approximate their fair values, as interest approximates market rates.

Advertising, Promotion and Catalog

The Company expenses the production costs of advertising the first time the advertising takes place. The advertising expenses for the years ended December 31, 2008, 2007 and 2006 amounted to \$18,392, \$12,765 and \$8,138, respectively and were included in Operating Expenses in the Consolidated Statements of Operations. The Company has cooperative advertising arrangements with certain vendors in its U.S. wholesale segment. For the years ended December 31, 2008, 2007 and 2006, cooperative advertising expenses were \$258, \$377 and \$376, respectively.

Shipping and Handling Costs

The Company incurs shipping and handling costs in its operations and accounts for such costs in accordance with EITF issue 00-10 Accounting for Shipping and Handling Fees and Costs . These costs consist primarily of freight expenses incurred for third-party shippers to transport products to its retail stores and distribution centers and to its wholesale and online retail customers. These costs are included in Cost of Sales in the Consolidated Statements of Operations. Amounts billed to customers are included in Net Sales.

Preferred stock

At December 31, 2008, 2007 and 2006, the Company was authorized to issue 1,000 shares of preferred stock with a par value of \$0.0001 with such designations, voting and other rights and preferences as may be determined from time to time by the Board of Directors. There were no shares issued or outstanding at December 31, 2008, 2007 or 2006. Shares may be issued in one or more series.

Deferred Rent, Rent Expense and Tenant Allowances

The Company occupies its retail stores and combined corporate office, manufacturing, and distribution center under operating leases generally with terms of one to ten years. Some leases contain renewal options for periods ranging from five to fifteen years under substantially the same terms and conditions as the original leases. Most of the store leases require payment of a specified minimum rent; a contingent rent based on a percentage of the store's net sales in excess of a specified threshold, plus defined escalating rent provisions. The Company straight-lines and recognizes its rent expense over the term of the lease (including probable lease renewals), plus the construction period prior to occupancy of the retail location, using a mid-month convention. Also included in rent expense are payments of real estate taxes, insurance and certain common area and maintenance costs in addition to the future minimum operating lease payments. Certain lease agreements provide for the Company to receive lease inducements or tenant allowances from landlords to assist in the financing of certain property. These inducements are recorded as a deferred credit and amortized as a reduction of rent expense over the term of the related lease.

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Contingencies

Certain conditions may exist as of the date the consolidated financial statements are issued, which may result in a loss to the Company but which will only be resolved when one or more future events occur or fail to occur. The Company assesses such contingent liabilities, and such assessment inherently involves an exercise of judgment. In assessing loss contingencies related to legal proceedings that are pending against the Company or unasserted claims that may result in such proceedings, the Company evaluates the perceived merits of any legal proceedings or unasserted claims as well as the perceived merits of the amount of relief sought or expected to be sought therein.

If the assessment of a contingency indicates that it is probable that a material loss has been incurred and the amount of the liability can be estimated, then the estimated liability would be accrued in the Company's consolidated financial statements. If the assessment indicates that a potentially material loss contingency is not probable but is reasonably possible, or is probable but cannot be estimated, then the nature of the contingent liability, together with an estimate of the range of possible loss if determinable and material, would be disclosed.

Loss contingencies considered remote are generally not disclosed unless they involve guarantees, in which case the guarantees would be disclosed.

Start-up Costs

The Company expenses as incurred all retail store start-up and organization costs, including travel, training, recruiting, salaries and other operating costs.

Web Site Development Costs

The Company capitalizes applicable costs incurred during the application and infrastructure development stage and expenses incurred during the planning and operating stage. As of December 31, 2008 and 2007, the Company had capitalized website development costs of \$697 and \$7, respectively, which are included in property and equipment in the accompanying Consolidated Balance Sheets.

Self-insurance accruals

The Company self-insures a significant portion of expected losses under the workers' compensation and healthcare benefits program. Accrued liabilities are recorded based on the Company's estimates of the ultimate costs to settle incurred claims, both reported and unreported.

Environmental Remediation Costs

The Company accrues for losses associated with environmental remediation obligations when such losses are probable and reasonably estimable. Accruals for estimated losses from environmental remediation obligations generally are recognized no later than completion of the remedial feasibility study. Costs of future expenditures for environmental remediation obligations are not discounted to their present value. As of December 31, 2008 and 2007, the Company did not have any accrued losses for environmental remediation obligations.

Comprehensive Income

In accordance with SFAS No. 130, Reporting Comprehensive Income, the Company is required to display comprehensive income and its components as part of its complete set of financial statements. Comprehensive income represents the change in stockholders' equity resulting from transactions other than stockholder investments and distributions. Included in accumulated other comprehensive income (loss) are changes in equity that are excluded from the Company's net income, specifically, unrealized gains and losses on foreign currency translation adjustments.

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Accounting Pronouncements-Newly Issued and Adopted

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157 Fair Value Measurements, (SFAS No. 157) which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. The Company has implemented SFAS No. 157 and has determined that the results did not have a material impact on its consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159 The Fair Value Option for Financial Assets and Financial Liabilities including an amendment of FASB Statement No. 115 (SFAS No. 159), which permits entities to choose to measure many financial instruments and certain other items at fair value. The fair value option established by this Statement permits all entities to choose to measure eligible items at fair value at specified election dates. A business entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. The Company has elected not to apply the fair value option to any of its eligible financial instruments. Accordingly, the provisions of SFAS No. 159 did not have any impact on its consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141R, Business Combinations (SFAS No. 141R), which replaces SFAS No. 141, Business Combinations. SFAS No. 141R establishes principles and requirements for determining how an enterprise recognizes and measures the fair value of certain assets and liabilities acquired in a business combination, including noncontrolling interests, contingent consideration, and certain acquired contingencies. SFAS No. 141R also requires acquisition-related transaction expenses and restructuring costs be expensed as incurred rather than capitalized as a component of the business combination. SFAS No. 141R will be applicable prospectively to business combinations for which the acquisition date is on or after January 1, 2009. SFAS No. 141R would have an impact on accounting for any businesses acquired after the effective date of this pronouncement.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements An Amendment of ARB No. 51 (SFAS No. 160). SFAS No. 160 establishes accounting and reporting standards for the noncontrolling interest in a subsidiary (previously referred to as minority interests). SFAS No. 160 also requires that a retained noncontrolling interest upon the deconsolidation of a subsidiary be initially measured at its fair value. Upon effectiveness of SFAS No. 160, the Company would be required to report any noncontrolling interests as a separate component of consolidated stockholders' equity. The Company would also be required to present any net income allocable to noncontrolling interests and net income attributable to the stockholders of the Company separately in its consolidated statements of operations. SFAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after January 1, 2009. SFAS No. 160 requires retroactive adoption of the presentation and disclosure requirements for existing minority interests. All other requirements of SFAS No. 160 shall be applied prospectively. SFAS No. 160 would have an impact on the presentation and disclosure of the noncontrolling interests of any non wholly-owned businesses acquired in the future.

In February 2008, the FASB issued FSP FAS 157-2, Effective Date of FASB Statement No. 157, which delays the effective date of SFAS No. 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis, with the exception of the application of the statement to non-recurring nonfinancial assets and nonfinancial liabilities. This FSP defers the effective date of SFAS No. 157 to fiscal years beginning after November 15, 2008 and the interim periods within those fiscal years for items within the scope of this FSP. The Company has evaluated this new FSP and has determined that it will not have a significant impact on the determination or reporting of our financial results.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Hedging Instruments and Hedging Activities an amendment of FASB Statement No. 133 (SFAS No. 161). SFAS No. 161, which is effective January 1, 2009, requires enhanced qualitative and quantitative disclosures with respect to derivatives

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and hedging activities. The Company does not anticipate SFAS No. 161 to have a material impact on its consolidated financial statements.

In April 2008, the FASB issued FASB Staff Position SFAS 142-3, *Determination of the Useful Life of Intangible Assets* (FSP SFAS 142-3). FSP SFAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, *Goodwill and Other Intangible Assets*. The objective of this FSP is to improve the consistency between the useful life of a recognized intangible asset under Statement 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS 141R, *Business Combinations*, and other U.S. Generally Accepted Accounting Principles (GAAP). FSP SFAS 142-3 is effective for fiscal years beginning after December 15, 2008. The adoption of FSP SFAS 142-3 is effective January 1, 2009, and is not expected to have a material the impact on the Company s consolidated financial statements.

In June 2008, the FASB ratified the consensus reached by the EITF on Issue No. 07-5, *Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity s Own Stock* (EITF No. 07-5). EITF No. 07-5 provides guidance for determining whether an equity-linked financial instrument (or embedded feature) is indexed to an entity s own stock. EITF No. 07-5 applies to any freestanding financial instrument or embedded feature that has all of the characteristics of a derivative or freestanding instrument that is potentially settled in an entity s own stock. To meet the definition of indexed to own stock, an instrument s contingent exercise provisions must not be based on (a) an observable market, other than the market for the issuer s stock (if applicable), or (b) an observable index, other than an index calculated or measured solely by reference to the issuer s own operations, and the variables that could affect the settlement amount must be inputs to the fair value of a fixed-for-fixed forward or option on equity shares. EITF No. 07-5 is effective for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. The Company will adopt EITF No. 07-5 as of January 1, 2009.

There are no other recently issued accounting pronouncements that are expected to have a material impact on the Company s consolidated financial statements.

NOTE 4 Business Acquisitions

On December 1, 2007 the Company entered into an agreement with an unrelated third party to assume a lease and purchase all of the assets of a garment sewing, dyeing and finishing plant. Purchase of these assets added garment dyeing capability to the Company s production process. The purchase included the assumption of the lease for the facility as well as the purchase of all of the tangible personal property at the plant. The Company accounted for this acquisition under the purchase method of accounting in accordance with SFAS No 141, *Business Combinations* . Under the purchase method the total purchase price has been allocated to the tangible assets acquired, based upon their estimated fair values. These Consolidated Financial Statements include the results of operations of this business since December 1, 2007.

The purchase price of the garment sewing, dyeing and finishing equipment amounted to \$1,600. The Company made payments totaling \$1,600 to the unrelated third party during December 2007.

On May 9, 2008 the Company completed an asset purchase with an unrelated third party to assume a lease and purchase all of the assets of a fabric dyeing and finishing plant. The purchase included the assumption of the lease for the facility as well as the purchase of all of the tangible personal property at the plant. The Company paid \$3,500 for the assumption of the lease and purchase of machinery and equipment. The acquisition of these assets was accounted for under the purchase method of accounting in accordance with SFAS No. 141 *Business Combinations*. The cost to acquire these assets was allocated to the respective assets and liabilities acquired based on their estimated fair values at the closing date.

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At December 31, 2008, the allocation of the cost to acquire these assets were as follows:

Property and equipment	\$ 2,918
Goodwill	956
Total assets acquired	3,874
Total liabilities assumed	374
Net assets acquired	\$ 3,500

Pro-forma financial information is not provided for these acquisitions as their impact was not material individually or in the aggregate to the Company's consolidated financial statements.

NOTE 5 Inventories, net

The components of inventories at December 31 are as follows:

	2008	2007
Raw materials	\$ 41,648	\$ 27,703
Work in process	1,450	3,238
Finished goods	108,674	80,842
	151,772	111,783
Less reserve for inventory shrinkage and obsolescence	(3,618)	(5,349)
Total, net of reserves	\$ 148,154	\$ 106,434

NOTE 6 Property and Equipment

The components of property and equipment at December 31 are as follows:

	2008	2007	Depreciation and Amortization Period (Years)
Machinery and equipment	\$ 38,556	\$ 24,120	5-7 years
Furniture and fixtures	28,408	19,731	5 years
Computers and software	19,520	11,566	3-5 years
Automobiles and light trucks	1,176	686	3 years
Leasehold Improvements	72,840	40,284	Shorter of the life of lease or useful life
Buildings	2,550	1,544	25 Years
Construction in progress	3,861	3,268	
	166,911	101,199	
Accumulated depreciation and amortization	(54,503)	(36,331)	
Total	\$ 112,408	\$ 64,868	

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For the years ended December 31, 2008, 2007, and 2006 depreciation and amortization expense relating to property and equipment (including capitalized leases) was \$20,197, \$13,033 and \$10,829, respectively. At December 31, 2008 and 2007, property and equipment includes \$11,370 and \$8,259, for assets held under capital leases, respectively. Accumulated amortization for these capital leases at December 31, 2008 and 2007 was \$6,921, and \$4,382, respectively.

Table of Contents**NOTE 7 Goodwill and Other Intangible Assets**

Goodwill of \$1,906 is assigned to the U.S. wholesale segment and is related to the acquisition of American Apparel Dyeing & Finishing, Inc. on June 2, 2005 and American Apparel Garment and Dyeing, Inc. on May 9, 2008. The carrying amount of goodwill was \$1,906 and \$950 as of December 31, 2008 and 2007, respectively.

Intangible Asset, net

The carrying amounts of intangible assets at December 31 are as follows:

	2008 Carrying Amount	2007 Carrying Amount	Amortization Period (Years)
Definite lived intangible assets:			
Deferred Financing Costs	\$ 5,058	\$ 1,603	Life of loan
Key money store leases	2,736	719	Life of lease
Broker and finder fees	1,656		Life of lease
Lease rights	1,774	998	Life of lease
	11,224	3,320	
Accumulated Amortization	(1,138)	(1,034)	
Total	\$ 10,086	\$ 2,286	

Deferred financing costs represent costs incurred in connection with the issuance of certain indebtedness and were capitalized as deferred costs and are being amortized over the term of the related indebtedness. The Company incurred related amortization expense of \$1,030 and \$685 for the years ended December 31, 2008 and 2007, respectively, which is recorded to interest expense.

Key money is the amount of funds paid to a landlord or tenant to acquire the rights of tenancy under a commercial property lease for a certain property. Key money represents the right to lease with an automatic right of renewal. This right can be subsequently sold by the Company or can be recovered should the landlord refuse to allow the automatic right of renewal to be exercised. Key money is amortized over the respective lease terms.

Lease rights are costs incurred to acquire the right to lease a specific property. A majority of our lease rights are related to premiums paid to landlords. Lease rights are recorded at cost and are amortized over the estimated useful term of the respective leases. Property lease terms are generally for ten years.

Aggregate amortization expense of other definite lived intangible assets included in the Consolidated Statements of Operations under the caption Operating Expenses for the years ended December 31, 2008, 2007 and 2006 was approximately \$647, \$273 and \$75, respectively.

As of December 31, 2008, estimated amortization expense for each of the five succeeding years is as follows:

	Amount
2009	\$ 4,674
2010	1,506
2011	1,461
2012	915
2013	538

Table of Contents**NOTE 8 Other Assets**

The components of other assets at December 31 are as follows:

	2008	2007
Lease security deposits	\$ 11,284	\$ 8,152
Worker's Compensation deposit	314	
Other	1,605	1,108
Total	\$ 13,203	\$ 9,260

NOTE 9 Accrued Expenses

The components of accrued expenses at December 31 are as follows:

	2008	2007
Accrued compensation and related taxes	\$ 5,571	\$ 4,834
Worker's compensation self-insurance reserves	7,433	4,838
Sales tax, value added tax, property taxes	2,494	1,700
Accrued interest	174	185
Gift cards / store credits	2,672	1,817
Accrued bonuses		2,500
Other	7,945	6,003
Total	\$ 26,289	\$ 21,877

NOTE 10 Debt

Debt at December 31 consists of the following:

	2008	2007
Credit Line Facilities		
Revolving Credit Facility, maturing July 2012 (a)	\$ 49,401	\$ 47,402
Revolving Credit Facility, due on demand (b)	409	1,170
	49,810	48,572
Term Loans and Notes Payable		
Term loan with private investment firm, refinanced March 2009 (c)	51,000	51,000
Other	558	1,000
Total debt	101,368	100,572
Less revolving credit facilities (a)(b)	(33,836)	(48,572)
Less current portion of debt	(482)	(51,358)
Debt, net of revolving credit facilities and current portion	\$ 67,050	\$ 642

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- (a) On July 2, 2007, the Company replaced its secured revolving credit facility of \$62,500 with an increased revolving credit facility (the BofA Credit Agreement) of \$75,000 from a new bank (the Bank). The BofA Credit Agreement was to expire on March 21, 2009, the date thirty days prior to the April 20, 2009 maturity date of the loan agreement with SOF Investments L.P. Private IV (SOF), as discussed below, unless the SOF loan was refinanced on terms acceptable to the Bank. The SOF loan was refinanced on March 13, 2009 (see Note 21). As such, the BofA Credit Agreement will now mature on July 2, 2012. Although the BofA Credit Agreement expires on July 2, 2012 and the Company has the intent and believes it will have the ability to maintain this debt outstanding for more than one year, the Company has classified its borrowings under the facility as a current liability in accordance with the provisions set forth in EITF

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95-22, Balance Sheet Classifications, Borrowings Outstanding Under Revolving Credit Agreements that include both a Subjective Acceleration Clause and a Lock-Box Arrangement. Accordingly, the borrowings under the BofA Credit Agreement represent short-term borrowings and are presented as a current liability net of amounts refinanced under the Lion Credit Agreement on March 13, 2009, as described above, of \$15,974 that was previously outstanding under the BofA Credit Agreement and such amounts will continue to be classified as a long-term liability as of December 31, 2008 in accordance with SFAS No. 6.

Borrowings under the BofA Credit Agreement are subject to certain advance provisions established by the Bank and are collateralized by substantially all of the Company's assets. Interest under the agreement is at LIBOR (2.59% at December 31, 2008) plus 4.5% or the Bank's prime rate (which rate can in no event be lower than LIBOR plus 2.5% per annum) (3.25% at December 31, 2008) plus 2.5%, at the Company's option. The average borrowings under the Company's revolving credit facility during the year ended December 31, 2008 were \$51,438.

Periodically, the Company has been in default of certain provisions of the BofA Credit Agreement. The Company has amended the BofA Credit Agreement on five occasions to address various matters, most recently on December 19, 2008. As a precondition to the effectiveness of the fifth amendment, Dov Charney, was required to make a subordinated loan to the Company in the amount of \$2,500 (see Note 11). Significant covenants included in the BofA Credit Agreement, as amended, include limiting the Company's capital expenditures to \$9,262 in the first quarter of 2009 and to approximately \$8,500 for the remainder of 2009. The Company was in compliance with the financial covenants at December 31, 2008.

(b) As of December 31, 2008, the CI Companies had a line of credit with a bank that provided for borrowings up to C\$4,000 due on demand, bearing interest at the bank's prime rate (3.5% at December 31, 2008 and 6.0% at December 31, 2007) plus 1.00% per annum payable monthly. This line of credit is secured by two \$7,500 moveable hypothecs, which provide for a charge on the CI Companies' accounts receivable, inventory and certain other moveable assets and by Section 427 Security under the Bank Act of Canada on inventory. The credit agreement contains various covenants which require the CI Companies to maintain certain financial ratios and commitments as defined by the bank. At December 31, 2008, the CI Companies were not in compliance with certain of the covenants. Subsequent to year end, the CI Companies signed a new banking agreement with its bank and the U.S. affiliate has subrogated its note in the amount of \$6,527 in favor of the bank. With this subrogation, the CI Companies are in compliance with the bank covenants.

(c) As of December 31, 2008, the Company had a term loan agreement with SOF originally dated January 18, 2007 with a balance of \$41,000, which was subsequently increased to \$51,000 on July 22, 2007. Indebtedness under the agreement bore interest at 16% per annum, payable monthly and was to mature on April 20, 2009. The SOF loan was fully repaid on March 13, 2009 from the proceeds of a term loan with a new lender (see Note 21). In accordance with SFAS No. 6, the outstanding term loan balance of \$51,000 at December 31, 2008 is reflected as a long-term liability in the accompanying consolidated balance sheet. The SOF term loan agreement required the Company to meet certain financial covenants. In the event the Company was in default under the agreement, the interest rate increased to 21% per annum and SOF had the right to demand payment in full of all outstanding indebtedness. The SOF term loan was collateralized by substantially all assets of the Company subject to prior liens with respect to any such assets under the Credit Agreement with the Bank.

The covenants included in the SOF Loan were substantially similar to the covenants included in the BofA Credit Agreement with the Bank (see above). The Company amended the SOF term loan agreement nine times, most recently on December 19, 2008. In connection with the ninth amendment, the Company paid SOF a fee of \$2,550 and issued to SOF a warrant (the "SOF Warrant") to purchase 1,000 shares of Company common stock at an exercise price of \$3.00 per share, which SOF Warrant is exercisable at any time during its term (see Note 15 for a description of the terms and accounting for the SOF Warrant). Under the terms of the ninth amendment, if the Company were to fail to raise \$16 million of financing by March 13, 2009, the Company would be required to issue to SOF warrants to purchase an additional 2,000 shares of the Company's common stock on the same terms as the SOF Warrants. As discussed above, the SOF Loan was repaid on March 13, 2009, and the additional SOF Warrants were not required to be issued.

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Required principal payments of (reflecting the SOF loan refinancing) debt are as follows:

Year Ending December 31,	
2009	\$ 52,380
2010	559
2011	493
2012	47,936
2013	80,000
	\$ 181,368

NOTE 11 Subordinated Notes Payable to Related Parties

During the year ended December 31, 2008, the Company repaid outstanding loan balances to the Company's CEO. Loans from the CEO were reduced from \$3,804 and \$2,232 at December 31, 2007 to \$0 and \$792 at December 31, 2008, respectively. Both loans bear interest at 6% commencing December 12, 2007 and were scheduled to mature in 2012. On December 19, 2008, the Company received \$2,500 from the CEO in exchange for a promissory note scheduled to mature in January 2013, which bears interest at 6%, payable in kind. Prior to December 12, 2007, related party loans were non-interest bearing and without terms of repayment. For the years ended December 31, 2008, December 31, 2007 and December 31, 2006, interest expense was \$346, \$277 and \$157, respectively. For the periods prior to December 12, 2007, interest has been imputed at an average rate of 14% and was credited as an addition to paid-in capital.

NOTE 12 Capital Lease Obligations

The Company leases certain equipment under capital lease arrangements expiring at various times through 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. The interest rates pertaining to these capital leases range from 6.1% to 17.9% (average interest rate is 11.7%).

Minimum future payments under these capital leases at December 31 are:

Year Ending December 31,	
2009	\$ 3,011
2010	1,738
2011	262
2012	93
2013	37
Total future minimum lease payments	5,141
Less: amount representing interest	(539)
Net minimum lease payments	4,602
Current portion	2,616
Long-term portion	\$ 1,986

Table of Contents**NOTE 13 Income Taxes**

For financial reporting purposes, income (loss) before income taxes includes the following components for the years ended December 31, 2008, 2007, and 2006:

	2008	2007	2006
United States	\$ 4,610	\$ 968	\$ (5,149)
Foreign	16,757	14,315	5,117
	\$ 21,367	\$ 15,283	\$ (32)

The (benefits) provisions for income taxes for the years ended December 31, 2008, 2007 and 2006 are as follows:

	2008	2007	2006
Current:			
Federal	\$ 2,198	\$ 92	\$
State	1,500	641	237
Foreign	7,192	5,985	1,793
Subtotal current	10,890	6,718	2,030
Deferred:			
Federal	(2,579)	(5,619)	
State	(987)	(1,231)	(258)
Foreign	(69)	(63)	(198)
Subtotal deferred	(3,635)	(6,913)	(456)
Total (benefit) provision for income taxes	\$ 7,255	\$ (195)	\$ 1,574

The following is a reconciliation of taxes at the U.S. federal statutory rate and the effective tax rate:

	2008	2007	2006
Taxes at the statutory federal tax rate of 35%	\$ 7,478	\$ 5,349	\$ (43)
Reduced federal tax rate for S Corporations		(5,124)	43
State tax, net of federal benefit	(7,817)	(3,467)	(2,853)
Change in valuation allowance	8,132	3,765	2,833
Change in tax rates due to conversion to C Corporation	980	(6,205)	
Federal general business tax credits	(829)		
Domestic production deduction	(495)		
Foreign taxes	(266)	5,461	1,594
Other	72	26	
Total (benefit) provision for income taxes	\$ 7,255	\$ (195)	\$ 1,574

As a result of the Merger the Company was required to change from a Subchapter S Corporation to a C Corporation. Accordingly the Company was required to recognize deferred tax assets and liabilities from the expected tax consequences of temporary differences between the book and tax basis of the Company's assets and liabilities at the date of the Merger. This resulted in a one-time deferred tax benefit of \$6,205 being recognized during the year ended December 31, 2007. Upon filing the 2007 tax returns during 2008 the Company determined the deferred tax

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asset recorded at December 31, 2007 should have been \$5,225, resulting in an adjustment to the current provision for income taxes aggregating \$980 for the year ended December 31, 2008.

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

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Deferred tax assets and liabilities consist of the following as of December 31, 2008 and 2007:

	2008	2007
Deferred tax assets:		
Allowance for doubtful accounts	\$ 563	\$ 735
Deferred rent	6,675	3,767
Accrued worker's compensation	2,980	1,895
Inventories	3,788	4,018
Accrued liabilities	620	894
California enterprise zone tax credits	18,859	10,709
Foreign currency translation loss	1,948	
Foreign tax credits		18
Fixed assets, foreign	153	101
Other	549	41
Total gross deferred tax assets	36,135	22,178
Less, Valuation allowance	(18,859)	(10,728)
Net deferred tax assets	17,276	11,450
Deferred tax liabilities:		
Prepaid expenses	(1,580)	(1,919)
Other	(48)	(424)
Fixed assets	(1,576)	(1,067)
Total gross deferred tax liabilities	(3,204)	(3,410)
Net deferred tax assets and liabilities	14,072	8,040
Less, current portion	5,628	4,894
Net long-term deferred tax assets and liabilities	\$ 8,444	\$ 3,146

At December 31, 2008, the Company has available California state tax credit carryforwards of \$18,859 that may be utilized to offset future California tax liabilities arising from designated enterprise zone areas. The California state tax credits do not expire. The Company believes it is not more likely than not that the California state tax credits will be utilized in the future. Consequently, the Company has provided valuation allowances of \$18,859 and \$10,709 for the years ended December 31, 2008 and December 31, 2007, respectively.

On January 1, 2007 the Company adopted the provisions of the Financial Accounting Standards Board (FASB) Interpretation No. 48, Accounting for Uncertainty in Income Taxes an Interpretation of FASB No. 109 (FIN No. 48). FIN No. 48 addresses the determination of how tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under FIN No. 48, the Company must recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate resolution. The Company did not recognize any additional liabilities for uncertain tax positions as a result of the implementation of FIN No. 48.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

	2008	2007
Gross unrecognized tax benefits at January 1	\$ 611	\$ 611
Increases for tax positions in current year	326	611

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Gross unrecognized tax benefits at December 31	\$ 937	\$ 611
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The Company's uncertain tax positions are related to tax years that remain subject to examination by the relevant taxing authorities. The Company is currently open to audit under the statute of limitations by the Internal Revenue Service for the calendar years ended December 31, 2006 through December 31, 2008. During 2008 the Company concluded an Internal Revenue Service audit of the 2005 calendar year tax return. There was no material impact to the Company as a result of the audit. The Company is currently being audited by the Canadian Inland Revenue Service for the years ended December 31, 2005 through December 31, 2007. The audit is still in its initial stages. Management does not expect there to be a material impact to the Company as a result of the audit. The Company and its subsidiaries' state and foreign tax returns are also open to audit under similar statute of limitations for the calendar years ended December 31, 2004 through December 31, 2008. It should be noted that through December 12, 2007, the Company was taxed as an S corporation in the United States and thereafter is taxed as a C corporation in the United States.

The gross unrecognized tax benefits at December 31, 2008 and 2007 are included in income taxes payable. The Company accrues interest on unrecognized tax benefits as a component of income tax expense. Penalties, if incurred, would be recognized as a component of income tax expense. The Company had no such accrued interest or penalties included in the accrued liabilities associated with unrecognized tax benefits as of the date of adoption.

The Company does not provide for U.S. Federal income taxes on the undistributed earnings (\$7,198 at December 31, 2008) of CI Companies which are considered permanently invested outside of the U.S. Upon distribution of the earnings in the form of dividends or otherwise, the Company would be subject to both U.S. income taxes (subject to an adjustment for foreign tax credits) and withholding taxes payable in Canada. Determination of the amount of the unrecognized deferred U.S. income tax liability is not practicable because of the complexities associated with the hypothetical calculation.

Additionally, the Company is subject to tax examinations for payroll, value added, sales-based and other taxes. A number of these examinations are ongoing and, in certain cases, have resulted in assessments from the taxing authorities. Where appropriate, the Company has made accruals for these matters which are reflected in the Company's consolidated financial statements.

NOTE 14 Related Party Transactions

In December 2005, the Company entered into an operating lease, which commenced on November 15, 2006, for its knitting facility with a related company, which is partially owned by the Chief Executive Officer of the Company. The monthly lease payments are \$52 and the lease expires in November 2011, with a five year extension, at the option of the Company. Rent expense was \$619, \$598 and \$0 for the years ended December 31, 2008, 2007 and 2006, respectively. Prior to the Merger, the stockholders of AA owned 50% of the building. After the Merger, the Chief Executive Officer owns 25% of the building. Pursuant to an Assignment Agreement executed in December 2007, the Chief Executive Officer transferred 6.25% of his ownership interest in the Company that owns the building to Martin Bailey, the Company's Chief Manufacturing Officer. The value of this assignment is de minimus.

During the years ended December 31, 2007 and 2006, the Company paid management fees charged by the Chief Executive Officer of \$5,302 and \$2,046, respectively. In addition consulting fees charged by an immediate family member of the Chief Executive Officer were \$211 and \$89 for the years ended December 31, 2007 and 2006, respectively.

See Note 11 Subordinated Notes Payable to Related Parties for a description of the loans made by the Chief Executive Officer to the Company.

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NOTE 15 Stock Transactions

Pursuant to the 2007 Plan, the Company's seven non-employee directors each received a stock grant (of fully vested shares) following the Closing of the Merger and will receive a stock grant for each year of service thereafter, equal to the number of shares of the Company's common stock having an aggregate market value of \$75 at the date of grant (Note 16). The initial stock grant was approved by the Board on February 6, 2008, subject to the filing and effectiveness of a registration statement on Form S-8, which was filed on April 17, 2008. Pursuant to the Board authorization for the initial stock grant, however, the number of shares awarded to the non-employee directors was to be determined using the highest closing price as of December 12, 2007, February 6, 2008 and April 17, 2008. Consequently, the Company issued to each non-employee director approximately 5 shares of common stock, based upon the December 12, 2007 closing price per share of \$15.60. The compensation expense associated with the share awards is approximately \$432 and is reflected in operating expenses for the year ended December 31, 2008 in the consolidated financial statements, and was based upon the February 6, 2008 closing price of \$12.85 per share.

On August 14, 2008, 1,851 shares of the Company's common stock (fully vested and not subject to any restrictions or conditions) having an aggregate value of \$12,102 were awarded to eligible manufacturing employees and included in cost of sales for the year ended December 31, 2008. Of the \$12,102, approximately \$5,174 was withheld for the payment of employment and withholding taxes and 1,058 shares with an aggregate value of \$6,922 were issued to employees and cash in the amount of \$6 was paid to employees in lieu of the issuance of fractional shares. The net share settlement is deemed to be a repurchase by the Company of its common stock. The value of the stock award was determined based upon the August 14, 2008 closing price per share of \$6.54.

On September 29, 2008, the Company granted approximately 13 shares of the Company's common stock (fully vested and not subject to any restrictions or conditions) to a former Endeavor employee in exchange for services performed. The compensation expense associated with the share grant is approximately \$98 and is reflected in operating expenses for the year ended December 31, 2008 in the consolidated financial statements, and was based upon the September 29, 2008 closing price per share of \$7.80.

As of December 31, 2008, the Company has not granted any stock awards under the 2007 Plan, other than as described above.

Accounting for Warrants

On December 21, 2005, the Registrant sold 15,000 units (Units) in the Offering at \$8.00 per Unit. On January 5, 2006, the Registrant sold an additional 1,161 Units pursuant to the underwriters' over-allotment option. Each Unit consisted of one share of the Company's common stock, and one redeemable common stock purchase warrant (the Endeavor Warrant). The Endeavor Warrant entitled the holder to purchase from the Company one share of common stock at an exercise price of \$6.00 commencing the later of the completion of the Merger or December 15, 2006 and expiring on December 14, 2009. The Endeavor Warrant was redeemable by the Company, at a price of \$.01 per Endeavor Warrant upon 30 days' notice after the Endeavor Warrant became exercisable, only in the event that the last sale price of the common stock is at least \$11.50 per share for any 20 trading days within a 30 trading day period ending on the third day prior to the date on which notice of redemption is given. Such notice of redemption was given on February 6, 2008. There was no cash settlement option for the Endeavor Warrant.

In connection with this Offering, the Company issued an option to the representative of the Underwriter to purchase 350 Units at an exercise price of \$10.00 per Unit (the Underwriters Purchase Option). The Underwriters Purchase Option was exercised in December, 2007 in a cashless conversion, resulting in the issuance of 204 shares of common stock and 204 Endeavor Warrants. Additionally, 200 Endeavor Warrants were exercised in December 2007 resulting in aggregate proceeds of \$1,200. As a result, as of December 31, 2007, there were 16,165 Endeavor Warrants outstanding, all with an exercise price of \$6.00 per share, expiring on December 14, 2009.

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On February 6, 2008, the Company called for redemption of all of its 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 exercised, generating net proceeds to the Company of \$65,619. The remaining 12 Endeavor Warrants were redeemed by the Company at a price of \$0.01 per Endeavor Warrant, where a portion of the Endeavor Warrants were exercised on a cashless basis. The Company issued 13,521 shares of common stock in connection with the redemption of the Endeavor Warrants.

On December 19, 2008, the Company entered into the Ninth Amendment with SOF to extend the maturity date of the SOF Loan from January 18, 2009 to April 20, 2009 (see Note 10). In conjunction with this extension, the Company issued to SOF the SOF Warrant to purchase 1,000 shares of common stock for an exercise price of \$3.00 per share, which exercise price is subject to adjustment under certain circumstances. The SOF Warrant has a five year term and expires on December 19, 2013. The fair value of the SOF Warrant of \$1,021 was determined under the Black-Scholes option pricing model. The calculation was based on a contractual term of five years, interest rate of 1.35%, volatility of 59.5% and no dividends. The cost related to the SOF Warrant will be recognized as interest expense over the remaining term of the SOF Loan.

The Company considered the provisions of EITF 07-5, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock, with respect to the SOF Warrant, and concluded that the SOF Warrant was not indexed to in the Company's common stock as a result of the price adjustment provisions. Accordingly, the SOF Warrant will be accounted for as a derivative instrument pursuant to SFAS No. 133 and anticipate a cumulative effect gain of \$214 recorded to retained earnings upon the adoption of EITF 07-05 on January 1, 2009.

Stock Repurchase

On May 23, 2008, the Company's Board of Directors authorized a common stock repurchase program that allows the Company to repurchase up to an aggregate of \$25,000 of the Company's outstanding common stock through open market and privately negotiated transactions based on prevailing market conditions and other factors. At December 31, 2008, the Company had repurchased 1,433 shares of the Company's common stock for \$10,001 at a weighted average price of \$6.98 per share, plus brokerage commissions of \$43, leaving \$14,999 remaining under the program. All of the shares repurchased have been recorded as treasury stock.

NOTE 16 Commitments and Contingencies

Operating Leases

The Company conducts retail operations under operating leases, which expire at various dates through 2020. The Company's primary manufacturing facilities and executive offices are currently being leased on a month to month basis. Future minimum rental payments (excluding real estate tax and maintenance costs) for retail locations and other leases that have initial or non-cancelable lease terms in excess of one year at December 31, 2008 are as follows:

	Amount
2009	\$ 55,343
2010	51,581
2011	48,885
2012	46,020
2013	43,886
Thereafter	145,189
Total	\$ 390,904

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Operating lease rent expense (including real estate taxes and maintenance costs) and leases on a month to month basis were approximately \$59,205, \$38,171 and \$30,154 for the years ended December 31, 2008, 2007 and 2006, respectively. The Company did not incur any contingent rent (Note 3) during the same period. Rent expense is included in Cost of Sales and Operating Expenses in the accompanying Consolidated Statements of Operations.

Sales Tax

The Company has been contacted by the California State Board of Equalization in regard to scheduling a Sales and Use Tax audit for the period January 1, 2002 through December 31, 2004. No provision has been made for any future assessment, if any, which might be determined by the State Board of Equalization at the outcome of the audit.

California Franchise Tax Board

The Company has been contacted by the California Franchise Tax Board in regard to scheduling an audit related to California Enterprise Zone Tax Credits taken by the Company for the 2001 and 2002 income tax years. No provision has been made for any future assessment, if any, which might be determined by the California Franchise Tax Board at the outcome of the audit. However, the California Enterprise Zone Tax Credits have a full valuation allowance at December 31, 2008 and 2007 (Note 13).

Advertising

At December 31, 2008, the Company had approximately \$2,439 in open advertising commitments, which primarily relate to print advertisements in various newspapers and magazines during the remainder of 2009.

U.S. Immigration and Customs Enforcement

The Company has been contacted by U.S. Immigration and Customs Enforcement in regard to performing a review of the Company's compliance with Section 274A of the Immigration and Nationality Act, as amended by the Immigration Reform and Control Act of 1986. The review commenced in January 2008. If the Company is found to have failed to comply with federal law, it could be subject to various civil and criminal penalties. At this time no determination can be made as to the outcome of the review and therefore no provision has been made for a future assessment, if any, which might be imposed by U.S. Immigration and Customs Enforcement upon completion of the review.

Employment Agreements

At Closing, Dov Charney became the Company's Chief Executive Officer and President. None of the Company's other pre-Merger officers continued with the Company after the Acquisition. Dov Charney also entered into an employment agreement with the Company, effective at the Closing. Effective with the Closing, Dov Charney no longer receives a management fee as compensation. Concurrent with the Closing, Dov Charney entered into a three year employment agreement that provides an annual salary of \$750. He is also entitled to an annual performance bonus of 150% of base salary upon achievement of annual goals to be set by the compensation committee subsequent to the acquisition and a long-term performance bonus of 300% of base salary upon achievement of three-year goals to be set by the compensation committee. As of December 31, 2008, these annual goals have not been set by the compensation committee.

Unused Available Line of Credit

At December 31, 2008, the Company has a revolving credit facility with a Bank (Note 10a) providing for borrowings of up to \$75,000, of which \$49,401 is outstanding under this line of credit and \$12,142 was available for future borrowings at December 31, 2008.

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At December 31, 2008, the Company has a revolving credit facility with a bank (Note 10b) providing for borrowings of up to C\$4,000 (CAN \$), of which \$409 is outstanding under this line of credit and \$2,862 was available for future borrowings at December 31, 2008.

Compensation of Directors

The Company agreed to grant its non-employee directors annual stock grants equal to the number of shares of the Company's common stock, having an aggregate market value of \$75 at the time of grant (the Annual Grant), with grants being made at the Closing of the Merger and subject to the annual confirmation and ratification by the Board each year, on each anniversary of service thereafter. The Board determined in December 2008 that the Annual Grant to the non-employee directors that was scheduled for December 12, 2008, would be granted on January 12, 2009, and that beginning on December 12, 2009, each non-employee director on each such December 12th, would be automatically awarded the Annual Grant on each such date, without any further action by the Board.

Stock Awards to Employees

Pursuant to the Amended Acquisition Agreement, up to 2,710 shares of common stock may be issued to employees subsequent to the filing of the Form S-8 filed in April 2008. On August 14, 2008, 1,851 shares of common stock were awarded to eligible manufacturing employees. As of December 31, 2008, the Company estimates there are an additional 859 shares of common stock that may be awarded to eligible employees.

NOTE 17 Workers' Compensation Self-Insurance Reserves

Self Insurance Reserves

The Company uses a combination of third-party insurance and/or self-insurance for a number of risks including workers' compensation and general liability claims. General liability costs relate primarily to litigation that arises from store operations. Self-insurance reserves include estimates of both claims filed carried at their expected ultimate settlement value and claims incurred but not yet reported. The Company's estimated claim amounts are discounted using a rate with a duration that approximates the duration of the Company's self-insurance reserve portfolio. The Company's liability reflected on the Consolidated Balance Sheet represents an estimate of the ultimate cost of claims incurred as of the balance sheet date. In estimating this liability, the Company utilizes loss development factors based on Company-specific data to project the future development of incurred losses. Loss estimates are adjusted based upon actual claim settlements and reported claims. These projections are subject to a high degree of variability based upon future inflation rates, litigation trends, legal interpretations, benefit level changes and claim settlement patterns. Although the Company does not expect the amounts ultimately paid to differ significantly from its estimates, self-insurance reserves could be affected if future claim experience differs significantly from the historical trends and the assumptions applied.

The workers' compensation liability is based on estimate of losses for claims incurred, but not paid at year end. Funding is made directly to the providers and/or claimants by the insurance company. To guarantee performance under the workers' compensation program, as of December 31, 2008 and 2007, the Company has issued standby letters of credit in the amount of \$7,190 and \$5,940, respectively, with two insurance companies being the beneficiaries. At December 31, 2008 and 2007, the Company recorded a reserve of \$7,433 and \$4,838, respectively, for potential losses on existing claims as such amounts are believed to be probable and reasonably estimable.

Table of Contents**NOTE 18 Business Segment and Geographic Area Information***Segment Information*

The Company's management evaluates performance based on a number of factors; however, the primary measures of performance are the net sales and income or loss from operations of each segment, as these are the key performance indicators reviewed by management. Operating income or loss for each segment does not include corporate general and administrative expenses, interest expense and other miscellaneous income/expense items. Corporate general and administrative expenses include, but are not limited to: human resources, legal, information technology, accounting and finance, executive compensation, and various other corporate level activity related expenses. Such unallocated expenses remain within corporate. In the fourth quarter of 2008, the Company implemented and recorded a full year impact from changes to its intercompany transfer pricing policy which will significantly reduce the overall effective tax rate on its international earnings. While the application of the updated intercompany transfer pricing policy did not change the Company's revenue or operating performance on a consolidated basis, it impacted the allocation of gross profit and operating profit amongst the U.S. Wholesale, Canada and International segments in 2008 when compared to prior years. Intercompany charges related to the transfer pricing implementation included in cost of sales of the Canadian and International segments were \$5,306 and \$15,750, respectively, for the year ended December 31, 2008 and resulted in a corresponding decrease in cost of sales in the U.S. wholesale segment of \$21,056. The accounting policies of all operating segments are the same as those described in the summary of significant accounting policies in Note 3.

The Company reports the following segments: U.S. Wholesale, U.S. Retail, Canada, and International. All of the Company's sales fall into one of these segments. The Company believes this scheme of segment reporting reflects both the way its business segments are managed and the way each segment's performance is evaluated. The U.S. Wholesale segment includes the Company's wholesale operations in the U.S. Wholesale operations consist of sales of undecorated apparel products to distributors and third party screen printers. The U.S. Retail segment includes the Company's retail operations in the U.S. The Canada segment includes both retail and wholesale operations in Canada. The International segment includes both retail and wholesale operations outside of the U.S. and Canada.

U.S. Internet sales are recorded in the U.S. Wholesale segment. Canada internet sales are included in the Canada segment and overseas International internet sales are included in the International segment. As of December 31, 2008, U.S. Retail was comprised of 148 Company owned retail stores operating in the United States; the Canada segment was comprised of 37 retail stores; and the International segment was comprised of 75 retail stores. All of these retail stores sell the Company's apparel products directly to consumers.

The following table represents key financial information of the Company's business segments:

	For the Year ended December 31, 2008				
	U.S. Wholesale	U.S. Retail	Canada	International	Consolidated
Net sales to external customers	\$ 162,668	\$ 168,653	\$ 67,280	\$ 146,449	\$ 545,050
Gross profit	46,894	127,936	40,072	84,213	299,115
Income from operations	21,020	33,483	10,754	7,985	73,242
Depreciation and amortization	7,141	6,974	2,409	4,320	20,844
Capital expenditures	18,326	30,860	4,701	18,263	72,150
Deferred rent expense	262	4,042	321	3,121	7,746

	For the Year ended December 31, 2007				
	U.S. Wholesale	U.S. Retail	Canada	International	Consolidated
Net sales to external customers	\$ 144,478	\$ 115,615	\$ 42,407	\$ 84,544	\$ 387,044
Gross profit	40,148	88,833	27,141	59,351	215,473
Income from operations	19,743	24,756	1,522	14,795	60,816
Depreciation and amortization	4,927	4,395	1,983	2,001	13,306
Capital expenditures	5,343	9,329	1,984	7,139	23,795
Deferred rent (benefit) expense	(155)	1,507	156	539	2,047

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	For the Year ended December 31, 2006				
	U.S. Wholesale	U.S. Retail	Canada	International	Consolidated
Net sales to external customers	\$ 127,761	\$ 80,210	\$ 30,570	\$ 46,425	\$ 284,966
Gross profit	31,729	62,968	19,236	31,703	145,636
Income from operations	14,221	11,510	3,540	4,719	33,990
Depreciation and amortization	4,905	3,709	1,421	869	10,904
Capital expenditures	4,252	8,624	1,659	2,355	16,890
Deferred rent expense	2	1,641	323	128	2,094
Reconciliation to Income (loss) before Income Taxes for the year ended December 31,					

	2008	2007	2006
Consolidated Income from operations of reportable segments	\$ 73,242	\$ 60,816	\$ 33,990
Corporate expenses	(37,178)	(29,694)	(23,418)
Interest expense	(13,921)	(17,541)	(11,812)
Other income (expense)	(155)	980	607
Foreign currency gain (loss)	(621)	722	601
Consolidated Income (Loss) Before Income Taxes	\$ 21,367	\$ 15,283	\$ (32)

	2008	2007	2006
Net sales by location of customer			
United States	\$ 331,322	\$ 260,093	\$ 207,971
Canada	67,280	42,407	30,570
Europe (excluding the United Kingdom)	74,297	45,100	23,080
United Kingdom	35,653	17,647	10,031
Korea	10,453	9,186	5,048
Japan	14,909	9,840	6,499
Other foreign countries	11,136	2,771	1,767
Total Consolidated Net Sales	\$ 545,050	\$ 387,044	\$ 284,966

Long-lived assets Property and equipment, net, as of December 31,

	2008	2007
United States	\$ 79,286	\$ 43,984
Canada	7,251	6,623
Europe (excluding the United Kingdom)	12,682	7,273
United Kingdom	6,439	4,594
Korea	703	512
Japan	3,278	1,636
Other foreign countries	2,769	246
Consolidated Long-lived Assets	\$ 112,408	\$ 64,868
Identifiable assets by segment		
US Wholesale	\$ 178,060	\$ 125,422
US Retail	98,947	59,961
Canada	17,112	16,506
International	38,886	31,461

Total

\$ 333,005

\$ 233,350

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Foreign subsidiaries accounted for the following percentages of assets and total liabilities as of December 31,

	2008	2007
Total assets	16.8%	20.6%
Total liabilities	14.5%	17.4%

	Twelve Months Ended December 31,		
	2008	2007	2006
Net sales by class of customer:			
U.S. Wholesale			
Wholesale	\$ 137,185	\$ 125,609	\$ 118,534
Online Consumer	25,483	18,869	9,227
Total	\$ 162,668	\$ 144,478	\$ 127,761
U.S. Retail			
	\$ 168,653	\$ 115,615	\$ 80,210
Canada			
Wholesale	\$ 12,708	\$ 11,335	\$ 13,097
Retail	52,872	30,068	17,078
Online Consumer	1,700	1,004	395
Total	\$ 67,280	\$ 42,407	\$ 30,570
International			
Wholesale	\$ 14,510	\$ 12,631	\$ 6,153
Retail	119,749	65,297	37,425
Online Consumer	12,190	6,616	2,847
Total	\$ 146,449	\$ 84,544	\$ 46,425
Consolidated			
Wholesale	\$ 164,403	\$ 149,575	\$ 137,784
Retail	341,274	210,980	134,713
Online Consumer	39,373	26,489	12,469
Total	\$ 545,050	\$ 387,044	\$ 284,966

NOTE 19 Litigation

The Company is subject to various claims and contingencies in the ordinary course of its business, including those related to litigation, business transactions, employee-related matters and taxes, and others. When the Company is aware of a claim or potential claim, it assesses 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, the Company will record a liability for the loss. The liability recorded includes probable and estimable legal costs associated with the claim or potential claim. If the loss is not probable or the amount of the loss cannot be reasonably estimated, the Company discloses the claim if the likelihood of a potential loss is reasonably possible and the amount involved could be material. While there can be no assurances, the Company does not expect that any of its pending legal proceedings will have a material financial impact on the Company's results.

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. The Company denies all of Ms. Nelson's

allegations of wrongdoing. Ms. Nelson is seeking unspecified monetary damages and costs. The

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trial has been stayed, and the Court of Appeal of the State of California has reversed the Superior Court's denial of the Company's motion to compel arbitration pursuant to an agreement among the parties. The Company anticipates that arbitration will now occur. The insurance carrier for the Company's directors' and officers' insurance policy has asserted that it is not obligated to provide coverage for this proceeding. American Apparel intends 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 managers, supervisors and other employees of the Company in connection with its investigation. 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. American Apparel intends to aggressively defend any allegations of wrongdoing.

On March 31, 2008, Woody Allen filed suit against the Company, in the United States District Court for the Southern District of New York, for the alleged unauthorized use of his image. Through his suit, Mr. Allen is seeking monetary damages in an amount he believes to be in excess of \$10 million, disgorgement of any profits the Company may have realized as a result of its alleged unauthorized use of Mr. Allen's image, exemplary damages, and attorneys' fees and costs. The Company believes that Mr. Allen's claims are defensible and is vigorously litigating its position. In addition, the Company's insurance company has agreed, without any reservation of rights, to cover a portion of defense costs and any adverse judgment which may be entered against the Company, up to the policy limits of \$11 million, except for any exemplary damages which may be awarded.

The Company is currently engaged in other employment-related claims and other matters incidental to the Company's business. We believe that all such claims against the Company are without merit or not material, 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.

NOTE 20 Restatement of Previously Issued Consolidated Balance Sheet

Subsequent to the issuance of the Company's Form 10-K for the year ended December 31, 2008, the Company identified an error related to the classification of certain outstanding revolving credit facility borrowings as a long-term liability as of December 31, 2008. As a result, the Company has restated the accompanying consolidated balance sheet as of December 31, 2008 to reflect the revolving credit facility borrowings as a current liability.

The Company's BofA Credit Agreement requires that the Company maintain an arrangement similar to a traditional lock-box and contains certain clauses that would allow the bank, based on subjective conditions, to prohibit the Company from making new draws under the revolving line of credit or reduce the quantitative determination of the Company's borrowing base availability. Therefore, based on EITF 95-22, Balance Sheet Classification of Borrowings Outstanding under Revolving Credit Agreements That Include both a Subjective Acceleration Clause and a Lock-Box Arrangement and SFAS No. 6, Classification of Short-Term Obligations Expected to Be Refinanced, the Company should classify the outstanding amounts on the revolving credit facility as a current liability as the Company's ability to re-borrow under the BofA Credit Agreement can be canceled by the bank upon the occurrence of conditions that are not objectively determinable. On March 13, 2009, in connection with the proceeds from the term loans issued under the Lion Credit Agreement, the Company refinanced \$15,974 that was previously outstanding under the revolving credit facility and such amounts will

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continue to be classified as a long-term liability as of December 31, 2008 in accordance with SFAS No. 6. As such, the Company has determined the restatement adjustment to be \$32,938, which has been reflected as a current liability.

The following table presents the effects of the restatement adjustment on the Company's previously reported consolidated balance sheet as of December 31, 2008:

	As Originally Filed	Restatement Adjustment	As Restated
Revolving credit facilities and current portion of long-term debt	\$ 1,380	\$ 32,938	\$ 34,318
Total Current Liabilities	74,284	32,938	107,222
Long-Term Debt, Net of current portion	\$ 99,988	\$ (32,938)	\$ 67,050

NOTE 21 Subsequent Events

On January 12, 2009, the Company issued the second annual grant to each non-employee director approximately 35 shares of common stock, based upon the closing price per share of \$2.13.

On February 10, 2009, Dov Charney, loaned the Company \$4,000 in exchange for a promissory note (the Promissory Note). The Promissory Note matures in January 2013 and provides for interest at an annual rate of 6%, payable in kind. The Promissory Note contains customary events of default under which the Promissory Note may be accelerated, and the principal amount and accrued interest on the Promissory Note may be prepaid, in whole or in part, at any time without penalty.

On March 13, 2009, the Company entered into the Lion Credit Agreement. Pursuant to the Lion Credit Agreement, the Initial Lender made term loans to the Company in an aggregate principal amount equal to \$80,000, of which \$5,000 of such loans constitute a fee paid by the Company to Lion Capital LLP in connection with the Lion Credit Agreement. The term loans under the Lion Credit Agreement mature on December 31, 2013 and bear interest at a rate of 15% per annum, payable quarterly in arrears. At the Company's option, accrued interest may be paid (i) entirely in cash, (ii) paid half in cash and half in kind, or (iii) entirely in kind. The Company's obligations under the Lion Credit Agreement are secured by a second lien on substantially all of the assets of the Company. The Lion Credit Agreement 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 the Company to incur additional debt and liens) and a total leverage ratio financial maintenance covenant. The Company is permitted to prepay the loans in whole or in part at any time at its option, with no prepayment penalty.

A portion of the proceeds of the loans made under the Lion Credit Agreement was used by the Company to repay in full all outstanding amounts due and owing under the SOF Credit Agreement. The remaining proceeds were used to reduce the outstanding revolver balance under the BofA Credit Agreement, to repay \$3,250 of loans owed by the Company to Dov Charney, and to pay fees and expenses related to the transaction.

In connection with the loans under the Lion Credit Agreement, the Company issued to Lion a seven-year warrant, which is exercisable at any time during its term, to purchase an aggregate of 16,000 shares of the Company's common stock at an exercise price of \$2.00 per share. The Lion warrants will be recorded as a debt discount and a credit to stockholders' equity at its relative fair value of approximately \$15,000. The debt net of discount totaling approximately \$60,000, will be accreted to the \$80,000 par value of the loan using the effective interest method over the term of the Lion Credit Agreement. The warrant may be exercised by Lion by paying the exercise price in cash, pursuant to cashless exercise or 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

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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.

Item 9A. Controls and Procedures
(a) Disclosure Controls and Procedures

Under the supervision and participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our disclosure controls and procedures as such term is defined under Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act).

Based upon this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that as of December 31, 2008, our disclosure controls and procedures were ineffective due to material weaknesses existing in our internal controls as of December 31, 2007 (described below), which have not been fully remediated as of December 31, 2008.

(b) Management's Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate Internal Control over Financial Reporting (ICFR). We maintain ICFR designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Because of its inherent limitations, ICFR may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. Therefore, ICFR determined to be effective provides only reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

A material weakness is a deficiency, or a combination of deficiencies, in ICFR such that there is a reasonable possibility that a material misstatement of the Company's annual or interim financial statements will not be prevented or detected on a timely basis. Material weaknesses would permit information required to be disclosed by the Company in the reports that it files or submits to not be recorded, processed, summarized and reported, within the time periods specified in the Securities Exchange Commission's rules and forms.

Management evaluated our ICFR as of December 31, 2008. In making this assessment, management used the criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Marcum & Kliegman LLP, our independent registered public accounting firm, has issued an attestation report on our internal control over financial reporting as of December 31, 2008. This report is included below. As a result of this assessment and based on the criteria in the COSO framework, management has concluded that, as of December 31, 2008, our ICFR was not effective due to the existence of the following material weaknesses:

1) ***Inadequate Expertise in the application of U.S. Generally Accepted Accounting Principles:*** At its foreign offices, the Company did not have a sufficient number of adequately trained accounting personnel with appropriate expertise in United States generally accepted accounting principles (US GAAP). Also, the Company lacked sufficient US GAAP expertise to ensure that certain complex material and non-routine transactions are properly reflected in its consolidated financial statements. Consequently, the Company may not anticipate and identify accounting issues, or other risks critical to financial reporting, that could materially impact the consolidated financial statements.

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2) ***Inadequate Reviews:*** In certain instances, the Company's personnel, at both U.S. and foreign operations, did not perform adequate independent review of reconciliations and other processes.

3) ***Inadequate Financial Information Systems:*** The Company's world-wide financial information systems were not integrated and contained many manual processes that may prevent the Company from meeting regulatory filing requirements on a timely and accurate basis. The Company has also identified information technology control weaknesses in the areas of information security, end-user computing, systems program development and change controls.

(c) Remediation Activities

As previously reported, there were five material weaknesses in our internal control over financial reporting as of December 31, 2007. During Fiscal 2008 the Company remediated two material weaknesses and has taken substantial measures to remediate the remaining material weaknesses, described as follows:

Assessment of ICFR: The Company conducted an assessment of the effectiveness of the Company's ICFR. The Company considers this material weakness remediated.

Ineffective Entity-Level Controls: The Company hired additional staff with appropriate education, knowledge of US GAAP, SEC reporting experience and other professional qualifications to improve the quality of its financial reporting. The company instituted a COSO based evaluation over ICFR. Besides the additional Company staff, the Company retained third party technical experts to improve disclosure and ICFR, as well as to improve the timeliness and accuracy of its financial reporting. The Company considers this material weakness remediated.

Inadequate Expertise in the application of U.S. Generally Accepted Accounting Principles: The Company hired additional credentialed professional staff with greater knowledge of US GAAP in both its domestic operations, and in positions of oversight and management of its foreign operations. In addition, the Company engaged appropriate professional services firms in order to improve accuracy of its financial reporting under US GAAP in key foreign reporting locations. The Company's management has sufficient knowledge to review the work of internal and external subject matter experts, and reviews all work papers from its foreign operations to ensure compliance with US GAAP.

a. Accounting for Income Taxes: The Company has engaged a third party service provider and implemented training and review procedures over its income tax process to provide adequate knowledge and ensure proper review of the provision for income taxes, including deferred taxes, in its consolidated financial statements. The Company considers this material weakness remediated.

b. Financial Reporting by Foreign Subsidiaries: The Company has hired additional credentialed professional staff with greater knowledge of US GAAP in both its domestic operations, and in the oversight and management of its foreign operations. The Company has made substantial progress and is continuing its efforts toward remediation of this material weakness.

c. Other Accounting Matters: The Company has hired or retained sufficient competent personnel with appropriate US GAAP and SEC reporting experience to remediate this issue. The Company has made substantial progress and is continuing its efforts toward remediation of this material weakness.

Inadequate Reviews: The Company instituted and formalized multiple levels of review and internal controls at foreign and U.S. Operations for reconciliations and other processes which are deemed key to the financial statements. The Company's review processes have been implemented and the Company has made substantial progress and is continuing its efforts toward remediation of this material weakness.

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Inadequate Financial Information Systems: The Company has identified systems and applications that impact financial reporting and is taking actions to safeguard financial reporting information assets as well as to help ensure the integrity of financial information used in the preparation of financial reports. The Company has adopted an Information Technology framework, is documenting key information technology controls and is addressing control weaknesses that could potentially impact financial reporting. In addition, the Company has implemented a number of new policies, procedures, and controls in the areas of information security, change management, operations and end-user computing. The Company is in the process of implementing an integrated ERP system for its U.S. operations. It has reviewed its personnel and information systems for foreign operations and has added professional staff resources for review and control over financial reporting by the foreign operations. The Company has placed substantial mitigating controls around its heretofore manual consolidation process, and is in the process of implementing a high-level replacement system for those manual processes to further improve controls and to reduce the time required to produce its financial statements and regulatory filings. In addition, the Company has identified and implemented additional review controls over financial reporting to validate information derived from its information systems and ultimately reported in our financial statements. As the Company continues to upgrade various systems, controls and procedures, it is continuing to make substantial progress and is continuing its efforts toward remediation of this material weakness.

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM
ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

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

We have audited American Apparel, Inc.'s (the "Company") internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting 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 effective internal control over financial reporting was maintained in all material respects. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that degree of compliance with the policies or procedures may deteriorate.

A material weakness is a control deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Company's annual or interim financial statements will not be prevented or detected on a timely basis. The following material weaknesses have been identified and included in Management's Report on Internal Control Over Financial Reporting :

1) ***Inadequate Expertise in the application of U.S. Generally Accepted Accounting Principles:*** At its foreign offices, the Company did not have a sufficient number of adequately trained accounting personnel with appropriate expertise in United States generally accepted accounting principles (US GAAP). Also, the Company lacked sufficient US GAAP expertise to ensure that certain complex material and non-routine transactions were properly reflected in its consolidated financial statements. Consequently, the Company may not anticipate and identify accounting issues, or other risks critical to financial reporting, that could materially impact the consolidated financial statements.

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2) ***Inadequate Reviews:*** In certain instances, the Company's personnel, at both U.S. and foreign operations, did not perform adequate independent review of reconciliations and other processes.

3) ***Inadequate Financial Information Systems:*** The Company's world-wide financial information systems were not integrated and contained many manual processes that may prevent the Company from meeting regulatory filing requirements on a timely and accurate basis. The Company has also identified information technology control weaknesses in the areas of information security, end-user computing, systems program development and change controls.

These material weaknesses were considered in determining the nature, timing and extent of audit tests applied in our audit of the December 31, 2008 consolidated financial statements and financial statement schedule, and this report does not affect our report dated March 16, 2009.

In our opinion, because of the effect of the material weaknesses described above on the achievement of the objectives of the control criteria, American Apparel, Inc. has not maintained effective internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets as of December 31, 2008 and 2007 and the related consolidated statements of operations, stockholders' equity and comprehensive income (loss), and cash flows and related financial statement schedule for the years ended December 31, 2008, 2007 and 2006 of the Company and our report dated March 16, 2009 expressed an unqualified opinion on those financial statements and financial statement schedule.

/s/ Marcum LLP

Marcum LLP

(formerly Marcum & Kliegman LLP)

New York, NY

March 16, 2009

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PART IV

Item 15. Exhibits and Financial Statement Schedules

(a) Documents filed as part of this Amendment:

Financial Statements and Financial Statement Schedule: See Index to Consolidated Financial Statements in Part II, Item 8 of this Amendment.

(b) Exhibits: The exhibits listed in the accompanying index to exhibits are filed or incorporated by reference as part of this Amendment. *In reviewing the agreements included as exhibits to this Amendment, please remember they are included to provide you with information regarding their terms and are not intended to provide any other factual or disclosure information about the Company or the other parties to the agreements. The agreements contain representations and warranties by each of the parties to the applicable agreement. These representations and warranties have been made solely for the benefit of the other parties to the applicable agreement and:*

should not in all instances be treated as categorical statements of fact, but rather as a way of allocating the risk to one of the parties if those statements prove to be inaccurate;

have been qualified by disclosures that were made to the other party in connection with the negotiation of the applicable agreement, which disclosures are not necessarily reflected in the agreement;

may apply standards of materiality in a way that is different from what may be viewed as material to you or other investors; and

were made only as of the date of the applicable agreement or such other date or dates as may be specified in the agreement and are subject to more recent developments.

Accordingly, these representations and warranties may not describe the actual state of affairs as of the date they were made or at any other time. Additional information about the Company may be found elsewhere in this Amendment and in the Company's other public filings, which are available without charge through the SEC's website at <http://www.sec.gov>.

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Exhibit No.	Description
2.1	Acquisition Agreement, dated as of December 18, 2006 and amended and restated on November 7, 2007, by and among the Registrant, AAI Acquisition LLC, American Apparel, Inc., a California corporation, American Apparel, LLC, each of American Apparel Canada Wholesale Inc. and American Apparel Canada Retail Inc. (together the "CI companies"), Dov Charney, Sam Lim, and the stockholders of each of the CI companies (included as Annex A of the Definitive Proxy Statement (File No. 001-32697) filed November 28, 2007 and incorporated by reference herein)
3.1	Amended and Restated Certificate of Incorporation of the Registrant (included as Exhibit 3.1 of the Current Report on Form 8-K (File No. 001-32697) filed December 18, 2007 and incorporated by reference herein)
3.2	Bylaws of the Registrant (included as Exhibit 3.1 of the Current Report on Form 8-K (File No. 001-32697) filed November 9, 2007 and incorporated by reference herein)
3.3	Certificate of Amendment to Certificate of Formation of American Apparel (USA), LLC (included as Exhibit 3.3 to Form 10-K (File No 001-32697) filed March 17, 2008 and incorporated by reference herein)
4.1	Specimen Common Stock Certificate (included as Exhibit 4.2 of the Current Report on Form 8-K (File No. 001-32697) filed December 18, 2007 and incorporated by reference herein)
4.2	Registration Rights Agreement, dated December 12, 2007, by and among the Registrant and the stockholders listed on the signature page therein (included as Annex H of the Definitive Proxy Statement (File No. 001-32697) filed November 28, 2007 and incorporated by reference herein)
4.3	Voting Agreement, dated December 12, 2007, between the Registrant and the Stockholders listed on the signature page therein (included as Annex E of the Definitive Proxy Statement (File No. 001-32697), filed November 28, 2007 and incorporated by reference herein)
4.4	Lock-Up Agreement, dated December 12, 2007, between the Registrant and Dov Charney (included as Annex D of the Definitive Proxy Statement (File No. 001-32697), filed November 28, 2007 and incorporated by reference herein)
4.5	Letter Agreement Re: Extension of Lock-Up Agreement, dated March 13, 2009, among Dov Charney, Lion Capital (Guernsey) II Limited and the Registrant (included as Exhibit 10.5 of the Current Report on Form 8-K (File No 001-32697) filed March 16, 2009 and incorporated by reference herein)
4.6	Warrants to Purchase Shares of Common Stock of the Registrant, dated December 19, 2008, issued to SOF Investments, L.P. Private IV (included as Exhibit 10.2 of the Current Report on Form 8-K (File No. 001-32697) filed December 19, 2008 and incorporated by reference herein)
4.7	Warrants to Purchase Shares of Common Stock of the Registrant, dated March 13, 2009, issued to Lion Capital (Guernsey) II Limited (included as Exhibit 10.3 of the Current Report on Form 8-K (File No 001-32697) filed March 13, 2009 and incorporated by reference herein)
4.8	Investment Agreement, dated March 13, 2009, between the Registrant and Lion Capital (Guernsey) II Limited (included as Exhibit 10.2 of the Current Report on Form 8-K (File No 001-32697) filed March 16, 2009 and incorporated by reference herein)
4.9	Investment Voting Agreement, dated March 13, 2009, between the Registrant and Lion Capital (Guernsey) II Limited (included as Exhibit 10.4 of the Current Report on Form 8-K (File No 001-32697) filed March 16, 2009 and incorporated by reference herein)
10.1+	Employment Agreement, dated December 12, 2007, between the Registrant, American Apparel, LLC and Dov Charney (included as Annex J of the Definitive Proxy Statement (File No. 001-32697) filed November 28, 2007 and incorporated by reference herein)

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Exhibit No.	Description
10.2	Escrow Agreement, dated July 2, 2007, by and among the Registrant, Dov Charney and Continental Stock Transfer & Trust Company (included as Annex G of the Definitive Proxy Statement (File No. 001-32697) filed November 28, 2007 and incorporated by reference herein)
10.3+	Registrant's 2007 Performance Incentive Equity Plan (included as Annex C of the Definitive Proxy Statement (File No. 001-32697) filed November 28, 2007 and incorporated by reference herein)
10.4+	First Amendment to the 2007 Performance Equity Plan (included as Exhibit 10.1 of Current Report on Form 8-K (File No. 001-32697) filed October 30, 2008 and incorporated by reference herein)
10.5	Credit Agreement, dated as of July 2, 2007 (the BofA Credit Agreement), among American Apparel (USA), LLC (AAUSA and f/k/a AAI Acquisition LLC (successor by merger to American Apparel, Inc.)), the other borrowers thereto, the facility guarantors party thereto, Bank of America, N.A. (successor by merger to LaSalle Bank National Association) as issuing bank, the other lenders thereto, Bank of America, N.A. (successor by merger of LaSalle Business Credit, LLC, as agent for LaSalle Bank Midwest National Association, acting through its division, LaSalle Retail Finance) as administrative agent and collateral agent, and Wells Fargo Retail, Finance, LLC as the collateral monitoring agent. (included as Exhibit 10.8 of the Current Report on Form 8-K (File No. 001-32697) filed December 18, 2007 and incorporated by reference herein)
10.6	First Amendment to Credit Agreement, dated October 11, 2007, amending the BofA Credit Agreement (included as Exhibit 10.9 of the Current Report on Form 8-K (File No. 001-32697) filed December 18, 2007 and incorporated by reference herein)
10.7	Second Amendment and Waiver to Credit Agreement, dated November 26, 2007, amending the BofA Credit Agreement (included as Exhibit 10.10 of the Current Report on Form 8-K (File No. 001-32697) filed December 18, 2007 and incorporated by reference herein)
10.8	Third Amendment to Credit Agreement, dated December 12, 2007, amending the BofA Credit Agreement (included as Exhibit 10.7 of Amendment No. 1 to the Annual Report on Form 10-K/A (File No. 001-32697) filed March 28, 2008 and incorporated by reference herein)
10.9	Waiver to Credit Agreement, dated February 29, 2008, waiving certain provisions in BofA Credit Agreement (included as Exhibit 10.8 of Amendment No. 1 to the Annual Report on Form 10-K/A (File No. 001-32697) filed March 28, 2008 and incorporated by reference herein)
10.10	Waiver to Credit Agreement, dated May 16, 2008, waiving certain provisions in BofA Credit Agreement (included as Exhibit 10.28 of Quarterly Report on Form 10-Q (File No. 001-32697) filed May 16, 2009 and incorporated by reference herein)
10.11	Waiver to Credit Agreement, dated as of June 5, 2008, amending the BofA Credit Agreement (included as Exhibit 10.1 of Current Report on Form 8-K (File No. 001-32697) filed June 9, 2008 and incorporated by reference herein)
10.12	Fourth Amendment to Credit Agreement, dated June 20, 2008, amending the BofA Credit Agreement (included as Exhibit 10.1 of Current Report on Form 8-K (File No. 001-32697) filed June 24, 2008 and incorporated by reference herein)
10.13	Fifth Amendment to Credit Agreement, dated as of December 19, 2008, amending the BofA Credit Agreement (included as Exhibit 10.1 of Current Report on Form 8-K (File No. 001-32697) filed December 19, 2008 and incorporated by reference herein)
10.14	Sixth Amendment to Credit Agreement, dated as of March 13, 2009, amending the BofA Credit Agreement (included as Exhibit 10.7 of Current Report on Form 8-K (File No. 001-32697) filed March 16, 2009 and incorporated by reference herein)

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Exhibit No.	Description
10.15	Credit Agreement, dated as of January 18, 2007 (the SOF Agreement), among AAUSA, the Facility Guarantors, and SOF Investments, L.P. Private IV (SOF) (included as Exhibit 10.11 of the Current Report on Form 8-K (File No. 001-32697) filed December 18, 2007 and incorporated by reference herein)
10.16	Amendment No. 1 and Waiver to Credit Agreement of AAUSA, dated as of July 2, 2007, amending the SOF Agreement, among AAUSA, the Facility Guarantors, and SOF (included as Exhibit 10.12 of the Current Report on Form 8-K (File No. 001-32697) filed December 18, 2007 and incorporated by reference herein)
10.17	Amendment No. 2 and Waiver to Credit Agreement of AAUSA, dated as of November 9, 2007, amending the SOF Agreement, among AAI, the Facility Guarantors, and SOF (included as Exhibit 10.13 of the Current Report on Form 8-K (File No. 001-32697) filed December 18, 2007 and incorporated by reference herein)
10.18	Amendment No. 3 and Waiver to Credit Agreement of AAUSA, dated as of November 28, 2007, amending the SOF Agreement, among AAI, the Facility Guarantors, and SOF (included as Exhibit 10.14 of the Current Report on Form 8-K (File No. 001-32697) filed December 18, 2007 and incorporated by reference herein)
10.19	Amendment No. 4 and Waiver to Credit Agreement of AAUSA, dated as of December 12, 2007, amending the SOF Agreement, among AAI, the Facility Guarantors, and SOF (included as Exhibit 10.13 of Amendment No. 1 to the Annual Report on Form 10-K/A (File No. 001-32697) filed March 28, 2008 and incorporated by reference herein)
10.20	Amendment No. 5 and Waiver to Credit Agreement of AAUSA, dated as of February 29, 2008, amending the SOF Agreement, among American Apparel (USA), LLC, the Facility Guarantors, and SOF (included as Exhibit 10.14 of Amendment No. 1 to the Annual Report on Form 10-K/A (File No. 001-32697) filed March 28, 2008 and incorporated by reference herein)
10.21	Amendment No. 6 and Waiver to Credit Agreement of AAUSA, dated as of May 16, 2008, amending the SOF Agreement, among American Apparel (USA), LLC, the Facility Guarantors, and SOF (included as Exhibit 10.27 of Quarterly Report on Form 10-Q (File No. 001-32697) filed May 16, 2009 and incorporated by reference herein)
10.22	Amendment No. 7 to Credit Agreement of AAUSA, dated as of June 20, 2008, amending the SOF Agreement, among American Apparel (USA), LLC, the Facility Guarantors, and SOF (included as Exhibit 10.2 of Current Report on Form 8-K (File No. 001-32697) filed June 24, 2008 and incorporated by reference herein)
10.23	Amendment No. 8 to Credit Agreement of AAUSA, dated as of November 7, 2008, amending the SOF Agreement, among American Apparel (USA), LLC, the Facility Guarantors, and SOF (included as Exhibit 10.23 of Annual Report on Form 10-K (File No. 001-32697) filed March 16, 2009 and incorporated by reference herein)
10.24	Amendment No. 9 to Credit Agreement of AAUSA, dated as of December 19, 2008, amending the SOF Agreement, among American Apparel (USA), LLC, the Facility Guarantors, and SOF (included as Exhibit 10.3 of Current Report on Form 8-K (File No. 001-32697) filed December 19, 2008 and incorporated by reference herein)
10.25	Lease, dated June 9, 2004, by and between Titan Real Estate Investment Group, Inc., and Textile Unlimited Corp., E&J Textile Group, Inc., and Johnester Knitting, Inc. (jointly and severally) (included as Exhibit 10.15 of the Current Report on Form 8-K (File No. 001-32697) filed December 18, 2007 and incorporated by reference herein)

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Exhibit No.	Description
10.26	Assignment of Lessee's Interest in Lease and Assumption Agreement, dated as of June 2, 2005, by and between Textile Unlimited Corp., E&J Textile Group, Inc., and Johnester Knitting, Inc. (jointly and severally) and American Apparel Dyeing and Finishing, Inc. (included as Exhibit 10.16 of the Current Report on Form 8-K (File No. 001-32697) filed December 18, 2007 and incorporated by reference herein)
10.27	Lease, dated December 13, 2005, by and between American Central Plaza and AAI (included as Exhibit 10.17 of the Current Report on Form 8-K (File No. 001-32697) filed December 18, 2007 and incorporated by reference herein)
10.28	Lease Amendment, effective as of November 15, 2006, by and between American Central Plaza and AAI (included as Exhibit 10.18 of the Current Report on Form 8-K (File No. 001-32697) filed December 18, 2007 and incorporated by reference herein)
10.29	Lease Amendment, effective as of March 22, 2007, by and between American Central Plaza and AAI (included as Exhibit 10.19 of the Current Report on Form 8-K (File No. 001-32697) filed December 18, 2007 and incorporated by reference herein)
10.30	Credit facilities agreement, dated December 3, 2007, among The Toronto-Dominion Bank and American Apparel Canada Wholesale Inc./American Apparel Canada Grossiste Inc. and Les Boutiques American Apparel Canada Inc./American Apparel Canada Retail Inc. (included as Exhibit 10.20 of Amendment No. 1 to the Annual Report on Form 10-K/A (File No. 001-32697) filed March 28, 2008 and incorporated by reference herein)
10.31	Lease, dated as of January 1, 2004, by and between Alameda Produce Market, Inc. and AAI (included as Exhibit 10.21 of the Current Report on Form 8-K (File No. 001-32697) filed December 18, 2007 and incorporated by reference herein)
10.32	Lease, dated as of May 12, 2004, by and between Alameda Produce Market, Inc. and AAI (included as Exhibit 10.22 of the Current Report on Form 8-K (File No. 001-32697) filed December 18, 2007 and incorporated by reference herein)
10.33+	Employment Agreement, dated as of October 26, 2006, between the Registrant and Joyce E. Crucillo (included as Exhibit 10.23 of Amendment No. 1 to the Annual Report on Form 10-K/A (File No. 001-32697) filed March 28, 2008 and incorporated by reference herein)
10.34+	First Amendment to Employment Agreement, dated as of March 11, 2009, among the Registrant, AAUSA and Joyce E. Crucillo (included as Exhibit 10.34 of Annual Report on Form 10-K (File No. 001-32697) filed March 16, 2009 and incorporated by reference herein.)
10.35	Asset Purchase Agreement, dated as of December 1, 2007, by and between PNS Apparel, Inc., Blue Man Group, Inc., Allen S. Yi and American Apparel, Inc. (included as Exhibit 10.24 of Amendment No. 1 to the Annual Report on Form 10-K/A (File No. 001-32697) filed March 28, 2008 and incorporated by reference herein)
10.36	Promissory Note, dated December 11, 2007, between American Apparel Canada Wholesale Inc. and Dov Charney (included as Exhibit 10.26 of Amendment No. 1 to the Annual Report on Form 10-K/A (File No. 001-32697) filed March 28, 2008 and incorporated by reference herein)
10.37+	Executive Services Agreement, dated May 12, 2008, by and between Tatum, LLC and the Registrant (included as Exhibit 10.1 of Current Report on Form 8-K (File No. 001-32697) filed May 22, 2008 and incorporated by reference herein)
10.38+	Severance Agreement and Release, dated May 22, 2008, by and between the Registrant, AAUSA and all of its subsidiaries and Ken Cieply, former Chief Financial Officer (included as Exhibit 10.5 of Quarterly Report on Form 10-Q (File No. 001-32697) filed August 15, 2008 and incorporated by reference herein)

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Exhibit No.	Description
10.39	Promissory Note, dated December 19, 2008, between AAUSA, as maker, and Dov Charney, as payee (included as Exhibit 10.4 of Current Report on Form 8-K (File No. 001-32697) filed December 19, 2008 and incorporated by reference herein)
10.40+	Employment Agreement, dated January 27, 2009, by and between Glenn A. Weinman and the Registrant (included as Exhibit 10.1 of Current Report on Form 8-K (File No. 001-32697) filed February 2, 2009 and incorporated by reference herein)
10.41	Promissory Note, dated February 10, 2009, between AAUSA, as maker, and Dov Charney, as payee (included as Exhibit 10.1 of Current Report on Form 8-K (File No. 001-32697) filed February 12, 2009 and incorporated by reference herein)
10.42	Credit Agreement, dated as of March 13, 2009, among the Company, certain subsidiaries of the Company, the facility guarantors party thereto, Lion Capital (Guernsey) II Limited, as initial lender, other lenders from time to time party thereto and Lion Capital LLP, as the administrative agent and the collateral agent (included as Exhibit 10.1 of the Current Report on Form 8-K (File No 001-32697) filed March 13, 2009 and incorporated by reference herein)
10.43	Letter Agreement Re: Extension of Non-Competition and Non-Solicitation Covenants in Section 5.27(a) of the Merger Agreement, dated March 13, 2009, among Dov Charney, Lion Capital (Guernsey) II Limited and the Registrant (included as Exhibit 10.6 of the Current Report on Form 8-K (File No 001-32697) filed March 16, 2009 and incorporated by reference herein)
14.1	Registrant's Code of Ethics (included as Exhibit 14.1 of the Current Report for 8-K (File No. 001-32697) filed December 18, 2007 and incorporated by reference herein)
21.1	List of Subsidiaries (included as Exhibit 21.1 of Annual Report on Form 10-K (File No. 001-32697) filed March 16, 2009 and incorporated by reference herein.)
23.1*	Consent of Marcum & Kliegman LLP
31.1*	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2*	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1*	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2*	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

* Filed herewith.

+ Management contract or compensatory plan or arrangement.

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SIGNATURES

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

AMERICAN APPAREL, INC.

August 13, 2009

By:

/s/ DOV CHARNEY
Dov Charney
President and Chief Executive Officer
(Principal Executive Officer)

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