SABRE HOLDINGS CORP
Form 10-Q
May 15, 2002

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

ý **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the Quarterly Period Ended March 31, 2002.

OR

o **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the Transition Period From To _____________ to _____________

Commission file number 1-12175.

SABRE HOLDINGS CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**75-2662240**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
3150 Sabre Drive Southlake, Texas	**76092**
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code **(682) 605-1000**

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class A Common Stock, $.01 par value 144,480,759 as of May 9, 2002

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SABRE HOLDINGS CORPORATION

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

SABRE HOLDINGS CORPORATION
CONSOLIDATED BALANCE SHEETS
(Unaudited) (In thousands)

	March 31, 2002	December 31, 2001
Assets		
Current assets		
Cash	$ 20,319	$ 18,855
Marketable securities	797,557	648,032
Accounts receivable, net	370,052	327,816
Prepaid expenses	78,713	51,565
Deferred income taxes	44,880	45,970

	March 31, 2002	December 31, 2001
Total current assets	1,311,521	1,092,238
Property and equipment		
Buildings and leasehold improvements	155,710	254,487
Furniture, fixtures and equipment	40,523	49,845
Computer equipment	204,820	189,298
	401,053	493,630
Less accumulated depreciation and amortization	(178,709)	(205,181)
Total property and equipment	222,344	288,449
Deferred income taxes		19,611
Investments in joint ventures	177,754	169,949
Goodwill and intangible assets, net	698,616	672,145
Other assets, net	138,432	133,625
Total assets	$ 2,548,667	$ 2,376,017
Liabilities and stockholders' equity		
Current liabilities		
Accounts payable	$ 176,667	$ 158,839
Accrued compensation and related benefits	55,502	73,274
Accrued subscriber incentives	92,180	89,337
Deferred revenues	53,567	59,591
Other accrued liabilities	192,412	183,415
Total current liabilities	570,328	564,456
Deferred income taxes	29,960	
Pensions and other postretirement benefits	104,481	88,756
Notes payable	395,034	400,375
Other liabilities	66,292	60,938
Minority interests	243,301	219,716
Commitments and contingencies		
Stockholders' equity		
Preferred stock: $0.01 par value; 20,000 shares authorized; no shares issued		
Class A common stock, $0.01 par value; 250,000 shares authorized; 133,962 and 133,527 shares issued at March 31, 2002 and December 31, 2001, respectively	1,356	1,351
Additional paid-in capital	830,856	818,742
Retained earnings	315,373	227,986
Accumulated other comprehensive income	1,165	3,176
Less treasury stock at cost: 384 shares	(9,479)	(9,479)
Total stockholders' equity	1,139,271	1,041,776
Total liabilities and stockholders' equity	$ 2,548,667	$ 2,376,017

See Notes to Consolidated Financial Statements

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SABRE HOLDINGS CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited) (In thousands, except per share amounts)

	Three Months Ended March 31,	
	2002	**2001**
Revenues	$ 539,367	$ 573,414
Operating expenses		
Cost of revenues	289,787	362,858
Selling, general and administrative	115,956	99,267
Amortization of goodwill and intangible assets	13,630	66,428
Total operating expenses	419,373	528,553
Operating income	119,994	44,861
Other income (expense)		
Interest income	7,002	3,521
Interest expense	(5,684)	(16,193)
Other, net	19,888	(9,708)
Total other income (expense)	21,206	(22,380)
Minority interests	847	7,787
Income from continuing operations before income taxes	142,047	30,268
Provision for income taxes	54,660	29,855
Income from continuing operations	87,387	413
Income from discontinued operations, net		13,632
Income before cumulative effect of change in accounting method	87,387	14,045
Cumulative effect of change in accounting method, net of minority interests and income taxes		3,103
Net earnings	$ 87,387	$ 17,148
Earnings per common share basic		
Income from continuing operations	$ .66	$
Income from discontinued operations		.10
Cumulative effect of change in accounting method		.03

	Three Months Ended March 31,	
Net earnings	$ .66	$ .13
Earnings per common share diluted		
Income from continuing operations	$ .64	$
Income from discontinued operations		.10
Cumulative effect of change in accounting method		.03
Net earnings	$ .64	$ .13

See Notes to Consolidated Financial Statements

SABRE HOLDINGS CORPORATION
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
THREE MONTHS ENDED MARCH 31, 2002
(Unaudited) (In thousands)

	Class A Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Total
Balance at December 31, 2001	$ 1,351	$ 818,742	$ 227,986	$ 3,176	$ (9,479)	$ 1,041,776
Issuance of 506 shares of Class A common stock pursuant to stock option, restricted stock incentive and stock purchase plans	5	6,910				6,915
Tax benefit from exercise of employee stock options		1,919				1,919
Comprehensive income:						
Net earnings			87,387			87,387
Unrealized loss on foreign currency forward contracts, net of deferred income taxes				(106)		(106)
Unrealized loss on investments, net of deferred income taxes				(1,859)		(1,859)
Unrealized foreign currency translation loss				(46)		(46)
Total comprehensive income						85,376
Other		3,285				3,285
Balance at March 31, 2002	$ 1,356	$ 830,856	$ 315,373	$ 1,165	$ (9,479)	$ 1,139,271

See Notes to Consolidated Financial Statements.

SABRE HOLDINGS CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited) (In thousands)

	Three Months Ended March 31,	
	2002	**2001**
Operating Activities		
Net earnings	$ 87,387	$ 17,148
Adjustments to reconcile net earnings to cash provided by operating activities		
Depreciation and amortization	29,055	138,355
Deferred income taxes	51,568	68
Gain on sale of former headquarters building	(18,308)	
Minority interests	(847)	(7,787)
Tax benefit from exercise of stock options	1,919	6,402
Cumulative effect of change in accounting method, net		(3,103)
Other	18,057	26
Changes in operating assets and liabilities		
Accounts receivable	(71,866)	(88,817)
Prepaid expenses	(26,883)	(9,000)
Other assets	(2,727)	(22,746)
Accrued compensation and related benefits	(17,773)	(20,740)
Accounts payable and other accrued liabilities	34,861	55,807
Pensions and other postretirement benefits	15,725	5,662
Other liabilities	(17,851)	16,107
Cash provided by operating activities	82,317	87,382
Investing Activities		
Additions to property and equipment	(12,132)	(51,409)
Business combinations, net of cash acquired	(35,907)	(25,000)
Proceeds from sale of former headquarters building	80,000	
Proceeds from sale of minority interest in Sabre Pacific	23,466	
Purchases of marketable securities	(660,350)	(455,872)
Sales of marketable securities	508,359	425,353
Other investing activities, net	23,325	(7,855)
Cash used for investing activities	(73,239)	(114,783)
Financing Activities		
Proceeds from issuance of common stock	6,915	32,180
Other financing activities, net	(14,529)	
Cash provided by (used for) financing activities	(7,614)	32,180
Increase in cash	1,464	4,779
Cash at beginning of period	18,855	7,778
Cash at end of period	$ 20,319	$ 12,557

See Notes to Consolidated Financial Statements

SABRE HOLDINGS CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. General Information

Sabre Holdings Corporation is a holding company. Its sole direct subsidiary is Sabre Inc. Unless otherwise indicated, references herein to "we", "our" or "us" include Sabre Holdings Corporation and its direct and indirect consolidated subsidiaries.

We generate most of our revenues from continuing operations by providing travel marketing and distribution services to travel agencies and travel suppliers using the Sabre® global distribution system ("the *Sabre* system"), to consumers using the Travelocity.com Web site and to businesses using GetThere products. We also generate revenues from the development and marketing of airline software solutions.

2. Summary of Significant Accounting Policies

Basis of Presentation The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, these financial statements contain all adjustments, consisting of normal recurring accruals, necessary to present fairly the financial position, results of operations and cash flows for the periods indicated. The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Operating results for the three months ended March 31, 2002 are not necessarily indicative of results that may be expected for any other interim period or for the year ended December 31, 2002. Our quarterly financial data should be read in conjunction with our consolidated financial statements for the year ended December 31, 2001 (including the notes thereto), set forth in Sabre Holdings Corporation's Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 28, 2002.

Reclassifications Certain reclassifications have been made to the 2001 financial statements to conform to the 2002 presentation.

Recent Accounting Pronouncements In June 2001, the Financial Accounting Standards Board ("FASB") issued Statements of Financial Accounting Standards No. 141, *Business Combinations* ("FAS 141"), and No. 142, *Goodwill and Other Intangible Assets* ("FAS 142"), effective for fiscal years beginning after December 15, 2001. Under the new rules, goodwill and intangible assets deemed to have indefinite lives will no longer be amortized, but will be subject to annual impairment tests in accordance with the Statements. Other intangible assets will continue to be amortized over their useful lives.

We adopted FAS 141 and 142 effective January 1, 2002. Upon adoption of FAS 142, we no longer amortize goodwill and certain other indefinite lived intangible assets. The following table reflects income from continuing operations and net income adjusted to exclude amortization expense (including related tax effects) recognized in the periods presented related to goodwill and other indefinite lived intangible assets: (in thousands)

	Three Months Ended March 31,	
	2002	2001
Reported income from continuing operations	$ 87,387	$ 413
Add back goodwill and indefinite lived intangible assets amortization, net of tax		50,858
Adjusted income from continuing operations	$ 87,387	$ 51,271

	Three Months Ended March 31,	
Reported net earnings	$ 87,387	$ 17,148
Add back goodwill and indefinite lived intangible assets amortization, net of tax		50,858
Adjusted net earnings	$ 87,387	$ 68,006
Earnings per share		
Basic:		
Reported income from continuing operations	$ .66	$
Add back goodwill and indefinite lived assets amortization, net of tax		.39
Adjusted income from continuing operations	$ .66	$ .39
Reported net earnings	$ .66	$ .13
Add back goodwill and indefinite lived assets amortization, net of tax		.39
Adjusted net earnings	$ .66	$ .52
Diluted:		
Reported income from continuing operations	$ .64	$
Add back goodwill and indefinite lived assets amortization, net of tax		.38
Adjusted income from continuing operations	$ .64	$ .38
Reported net earnings	$ .64	$ .13
Add back goodwill and indefinite lived assets amortization, net of tax		.38
Adjusted net earnings	$ .64	$ .51

At March 31, 2002 and December 31, 2001, our intangible assets were comprised of the following: (in thousands)

		March 31, 2002		December 31, 2001	
	Weighted Average Useful Lives	Gross Carrying Amount, at Cost	Accumulated Amortization	Gross Carrying Amount, at Cost	Accumulated Amortization
Not Subject to Amortization:					
Goodwill		$ 666,885	$	$ 626,785	$
Tradenames/trademarks		7,682		7,682	
		674,567		634,467	
Subject to Amortization:					
Purchased technology	4 years	125,146	(44,262)	125,146	(36,592)

		March 31, 2002		December 31, 2001	
Acquired customer relationships	7 years	32,820	(6,244)	32,820	(4,950)
Non-compete agreements	4 years	17,059	(8,783)	17,059	(4,971)
Acquired contracts	3 years	8,261	(5,873)	8,261	(5,018)
		183,286	(65,162)	183,286	(51,531)
Total		$ 857,353	$ (65,162)	$ 817,753	$ (51,531)

At December 31, 2001, accumulated amortization of $381 million and $6 million relating to goodwill and trade names/trademarks, respectively, were reclassed against the gross cost of the related asset.

Amortization expense relating to intangible assets subject to amortization totaled $14 million and $9 million during the three months ended March 31, 2002 and 2001, respectively. Amortization expense for the three months ended March 31, 2002 includes a one-time charge of $3 million for the write-down of a non-compete agreement that was determined to be unrecoverable.

The goodwill balance of $666,885 and $626,785 at March 31, 2002 and December 31, 2001, respectively, includes $94 million of goodwill related to our investments in joint ventures. Goodwill resulting from joint ventures is included in investments in joint ventures in the accompanying balance sheet.

Estimated amortization expense relating to intangible assets subject to amortization for each of the five succeeding years is as follows (in thousands):

2002	$ 45,422
2003	37,637
2004	32,089
2005	7,833
2006	3,838

Changes in the carrying amount of goodwill are as follows: (in thousands)

	Travel Marketing and Distribution	Travelocity.com	GetThere	Airline Solutions	Total
Three months ended March 31, 2002:					
Balance at beginning of period	$ 123,719	$ 97,602	$ 401,740	$ 3,724	$ 626,785
Goodwill acquired		41,117			41,117
Goodwill adjustments			(869)	(148)	(1,017)
Balance at end of period	$ 123,719	$ 138,719	$ 400,871	$ 3,576	$ 666,885

Prior to the adoption of FAS 142, our policy was to evaluate goodwill for impairment on an undiscounted projected future cash flows basis. Beginning January 1, 2002, we evaluate goodwill and indefinite lived intangible assets based on fair value. We performed the first of the required impairment tests of goodwill and indefinite lived intangible assets pursuant to FAS 142 as of January 1, 2002 and determined that no impairments were necessary.

The FASB has also recently issued FAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* ("FAS 144"), which we adopted on January 1, 2002. The FASB's new rules on asset impairment supersede FAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of* ("FAS 121").

FAS 144 retains the requirements of FAS 121 to (a) recognize an impairment loss only if the carrying amount of a long-lived asset is not recoverable from its undiscounted cash flows and (b) measure an impairment loss as the difference between the carrying amount and fair value of the asset, but removes goodwill from its scope. This aspect of FAS 144 will primarily affect our accounting for intangible assets subject to amortization, property and equipment, and certain other long-lived assets.

FAS 144 significantly changes the criteria that would have to be met to classify an asset as held-for-sale. Under the provisions of FAS 144, assets to be disposed of will be stated at the lower of their fair values or carrying amounts and depreciation no longer recognized.

FAS 144 also supersedes the provisions of Accounting Principles Board ("APB") Opinion No. 30, *Reporting the Results of Operations Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions* ("APB 30"), with regard to reporting the effects of a disposal of a segment of a business, and requires expected future operating losses from discontinued operations to be displayed in discontinued operations in the period(s) in which the losses are incurred (rather than as of the measurement date as presently required). In addition, more dispositions will qualify for discontinued operations treatment in the income statement.

The adoption of FAS 144 did not have a significant effect on our financial condition or results of operations.

3. Discontinued Operations

On July 2, 2001 we completed a transaction with Electronic Data Systems Corporation ("EDS") which provided for (i) the sale of our infrastructure outsourcing business and information technology ("IT") infrastructure assets and associated real estate to EDS (the "Asset Purchase Agreement"), (ii) a 10-year contract with EDS to manage our IT systems (the "IT Outsourcing Agreement"), and (iii) agreements with EDS to jointly market IT services and software solutions to the travel and transportation industries (the "Marketing Agreements").

The disposition of the infrastructure outsourcing business represents the disposal of a business segment under APB 30. The accompanying consolidated financial statements have been reclassified to present the results of discontinued operations separately for the three months ended March 31, 2001. Summarized financial information for the discontinued operations is as follows (in thousands):

	Three Months Ended March 31, 2001	
Revenues	$	181,273
Income before provision for income taxes	$	22,224
Provision for income taxes		8,592
Income from discontinued operations	$	13,632

4. Significant Events

Acquisition of Site59

On March 27, 2002, Travelocity.com completed the acquisition of Site59.com, Inc. ("Site59"), an online seller of last-minute merchant model air, hotel and rental car inventory, for approximately $43 million, including related costs and employee stock options assumed in the acquisition. Subsequent to the acquisition, Site59 is our wholly-owned subsidiary. The results of operations of Site59 have been included in our consolidated statement of income and the results of operations of our Travelocity.com segment from the date of acquisition.

Travelocity.com intends to operate Site59 as a separate unit and expects to begin generating revenue from last-minute travel operations immediately. Travelocity.com plans to begin selling hotel rooms using inventory from Site59 in Summer 2002.

The following table summarizes the estimated fair value of the assets acquired and liabilities assumed at the date of acquisition. We are in the process of obtaining third party valuations of the purchase price allocation. Because the purchase price valuation is not complete and amounts are not yet finalized, we are not able to provide the break out of identifiable intangible assets and goodwill. The following preliminary purchase price allocation, including the allocation of value to intangible assets other than goodwill, will be modified as further information becomes available (in thousands):

Working capital acquired	$	1,770
Long term assets		2,147
Goodwill and other intangible assets		38,850
Long term liabilities		(76)
Total Purchase Price	$	42,691

The acquired goodwill will not be deductible for tax purposes.

Events of September 11, 2001

On September 11, 2001, the United States was the target of terrorist attacks of unprecedented scope involving the hijacking and destruction of multiple passenger aircraft operated by commercial air carriers. Air travel in the United States was suspended for several days after the attacks. As a consequence, we have experienced significant decreases in bookings volumes due to reduced travel in the United States and, to a lesser degree, internationally. Our results of operations for the three

months ended March 31, 2002 were negatively affected by this reduction in travel. Our total bookings in the U.S. were approximately 17.8% lower during the three months ended March 31, 2002 than in the same period one year ago.

Sale of Previous Headquarters

On January 31, 2002, we sold our previous headquarters office facility in Fort Worth, Texas to American Airlines. We received proceeds of approximately $80 million in cash, and recognized a pre-tax gain of approximately $18 million as a result of the sale.

5. Income Taxes

The provision for income taxes relating to continuing operations differs from amounts computed at the statutory federal income tax rate as follows (in thousands):

	Three Months Ended March 31,			
	2002		2001	
Income tax provision at statutory federal income tax rate	$	49,716	$	10,593
State income taxes, net of federal benefit		4,308		1,779
Nondeductible goodwill amortization				17,415
Other, net		636		68
Total provision for income taxes	$	54,660	$	29,855

6. Derivatives

We adopted Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* ("FAS 133") effective January 1, 2001.

We recognized a cumulative gain in earnings relating to the HRN warrants during the three months ended March 31, 2001 upon adoption of FAS 133 of approximately $3 million, net of minority interest of approximately $2 million and deferred income taxes of approximately $2 million. During March 2001, we extended our affiliation agreement with HRN through July 31, 2005 and expanded the scope of the HRN relationship. In connection with the expanded and extended agreement, we received additional vested HRN warrants with a fair value of approximately $30 million on the date of receipt. We will recognize this amount as revenue over the extended term of the agreement. During the three months ended March 31, 2002 we recognized revenue relating to amortization of the fair value of the HRN warrants received at contract origination and modification totaling approximately $2.2 million compared to $0.9 million for the three months ended March 31, 2001. We may also vest in additional warrants in the future based upon the achievement of certain performance metrics. During the three months ended March 31, 2002, we received additional HRN warrants, based on certain performance metrics, with a fair value of approximately $2.7 million compared to $0.3 million for the three months ended March 31, 2001. Such amounts have been recognized as revenue in the periods the warrants were earned. During the three months ended March 31, 2002, we completed a cashless exercise of HRN warrants and received approximately 36,000 shares of HRN stock, which were disposed of for cash proceeds totaling approximately $1.6 million. No significant gain or loss was realized relating to such disposals. As of March 31, 2002 we hold 61,974 unexercised HRN warrants.

We are a party to certain foreign currency forward contracts. We have designated our foreign currency forwards as a cash flow hedge. The cumulative effect of adoption of FAS 133 related to these foreign currency forwards was insignificant. Amounts reclassified from other comprehensive income to earnings during the three months ended March 31, 2002 and 2001 relating to the forwards were not significant. There was no hedging ineffectiveness recorded in earnings relating to the forwards during the three months ended March 31, 2002 and 2001.

In connection with our issuance in August 2001 of $400 million principal amount in unsecured notes ("Notes") with a fixed interest rate of 7.35%, we entered into two interest rate swaps. We have designated the swaps as fair value hedges of $100 million and $200 million principal amount, respectively, of the Notes. Because the critical terms of the Notes and the swaps match, the swaps are considered a perfectly effective hedge against changes in the fair value of the Notes due to changes in the LIBOR rate. Changes in the fair value of the swaps are recognized as a component of other income in each reporting period. Additionally, the carrying value of the Notes is adjusted by a like amount, with the adjustment recognized as a component of other income. As of March 31, 2002, we had recorded a hedging liability of approximately $3 million, which is included in other liabilities in the accompanying balance sheet, and a corresponding decrease in the carrying value of the Notes relating to these swaps.

The estimated fair values of our derivatives as of March 31, 2002 and 2001 are provided below (in thousands):

	Asset/(Liability) March 31,	
	2002	**2001**
HRN Warrants	$ 2,734	$ 21,400
Foreign currency forwards	185	(913)
Interest rate swaps	(2,532)	
	$ 387	$ 20,487

Derivative assets and liabilities are classified as current or long-term other assets and other liabilities, respectively, in the accompanying balance sheet, depending on the date of settlement of the contract.

7. Earnings Per Share

The following table reconciles weighted average shares used in computing basic and diluted earnings per common share (in thousands):

	Three Months Ended March 31,	
	2002	2001
Denominator for basic earnings per common share weighted-average shares	133,320	130,847
Dilutive effect of stock awards and options	3,159	2,511
Denominator for diluted earnings per common share adjusted weighted-average shares	136,479	133,358

8. Segment Reporting

We have four reportable segments: Travel Marketing and Distribution, which includes Emerging Businesses, Travelocity.com, GetThere, and Airline Solutions. The Travel Marketing and Distribution segment distributes travel services to travel agencies ("subscribers"). Through our global distribution system, subscribers can access information about and book reservations with airlines and other providers of travel and travel-related products and services. The Travelocity.com segment distributes travel services to individual consumers. Through the Travelocity.com Web site, individual consumers can compare prices, make travel reservations and obtain destination information online. GetThere distributes travel services online directly to businesses. GetThere is the world's largest provider of Web-based travel reservations systems for major corporations and airlines. The Airline Solutions segment primarily provides software development, reservations hosting, consulting solutions and other products and services to airlines and other travel providers. Our reportable segments are strategic business units that offer different products and services and are managed separately because each business requires different market strategies.

The segment information is presented on a basis that excludes certain special items that are summarized below. This presentation is consistent with the manner in which our management assesses the operating performance of our business segments.

Selected information for our four reportable segments for the three months ended March 31, 2002 and 2001 follows (in thousands):

	Three Months Ended March 31,	
	2002	2001
Revenues from external customers:		
Travel Marketing and Distribution	$ 414,816	$ 456,540
Travelocity.com	58,180	55,174
GetThere	11,630	10,981
Airline Solutions	52,328	46,610
Total	$ 536,954	$ 569,305
Intersegment revenues:		
Travel Marketing and Distribution	$ 6,024	$ 6,321
Travelocity.com	16,316	17,677

	Three Months Ended March 31,	
GetThere	161	
Airline Solutions		2,075
Total	$ 22,501	$ 26,073
Equity in net income of equity method investees:		
Travel Marketing and Distribution	$ 3,244	$ 4,109
Travelocity.com	(831)	
Total	$ 2,413	$ 4,109
Total consolidated revenues:		
Travel Marketing and Distribution	$ 424,084	$ 466,970
Travelocity.com	73,665	72,851
GetThere	11,791	10,981
Airline Solutions	52,328	48,685
Elimination of intersegment revenues	(22,501)	(26,073)
Total	$ 539,367	$ 573,414
Segment operating income (loss) excluding special items:		
Travel Marketing and Distribution	$ 136,412	$ 127,107
Travelocity.com	6,031	425
GetThere	(9,173)	(16,562)
Airline Solutions	6,958	4,392
Net corporate allocations	277	(188)
Total	$ 140,505	$ 115,174

A summary of the special items and reconciliation to consolidated operating income is set forth below (in thousands):

	Three Months Ended March 31,	
	2002	2001
Travel Marketing and Distribution:		
Goodwill and other intangibles amortization	$ 4,555	$ 1,226
Stock compensation		
Total Travel Marketing and Distribution	4,555	1,226

	Three Months Ended March 31,	
Travelocity.com:		
Goodwill and other intangibles amortization	660	21,160
Tender offer expenses	6,776	
Stock compensation	293	419
Total Travelocity.com	7,729	21,579
GetThere:		
Goodwill and other intangibles amortization	6,606	41,435
Stock compensation	64	1,665
Severance and integration expenses		1,386
Total GetThere	6,670	44,486
Corporate:		
Goodwill and other intangibles amortization	1,415	2,607
Stock compensation	142	415
Total Corporate	1,557	3,022
Total special items	$ 20,511	$ 70,313
Consolidated operating income (loss):		
Travel Marketing and Distribution	$ 131,857	$ 125,881
Travelocity.com	(1,698)	(21,154)
GetThere	(15,843)	(61,048)
Airline Solutions	6,958	4,392
Corporate Allocations	(1,280)	(3,210)
Total	$ 119,994	$ 44,861

9. Subsequent Events

Tender Offer for Travelocity.com Common Stock

On February 19, 2002 we announced our intent to make a cash tender offer for all of the approximately 16.7 million outstanding publicly-held common shares of Travelocity.com that we did not own. At the time, we had an approximate 70% ownership stake in Travelocity.com. We commenced the tender offer on March 5, 2002 and completed it on April 8, 2002, promptly paying the tender offer price of $28.00 per share for each share tendered. We effected an ensuing short-form merger, whereby Travelocity.com became our indirect wholly owned subsidiary, on April 11, 2002. In the merger, each outstanding publicly-held share not tendered in the tender offer (other than shares held by stockholders exercising appraisal rights) was converted into a right to receive $28.00 in cash. The aggregate cost of the tender offer and the ensuing merger was approximately $468 million. We used available balances of cash and marketable securities to complete the acquisition.

Equity Offering

During April 2002, we completed an underwritten public offering of 8.2 million shares of Class A common stock at $44.50 per share. We also granted the underwriters a 30-day option to purchase an additional 1.23 million shares to cover over-allotments, which was also completed in April. The sale of a total of 9.43 million shares resulted in net proceeds to us of approximately $399.7 million. We plan to use the proceeds from the offering for general corporate purposes.

10. Supplemental Guarantor/Non-Guarantor Financial Information

The obligations of Sabre Holdings Corporation (Sabre Holdings) have been guaranteed by its wholly owned operating subsidiary, Sabre Inc. The following financial information presents condensed consolidating balance sheets, statements of income and statements of cash flows for Sabre Holdings, Sabre Inc. and non-guarantor subsidiaries. The information has been presented as if Sabre Holdings accounted for its ownership of Sabre Inc., and Sabre Inc. accounted for its ownership of the non-guarantor subsidiaries, using the equity method of accounting.

Sabre Inc. and certain non-guarantor subsidiaries are parties to various intercompany agreements which affect the amount of operating expenses reported in the following condensed consolidating statements of income. Among other things, fees are paid by Sabre Inc. to a non-guarantor subsidiary relating to the use of trademarks, trade names, etc. owned by a non-guarantor subsidiary; incentive and marketing payments are made by Sabre Inc. to non-guarantor subsidiaries relating to the use and distribution of the *Sabre* system; and payments are made by non-guarantor subsidiaries to Sabre Inc. for access to the *Sabre* system under the terms of these agreements. During the three months ended March 31, 2002 and 2001 Sabre Inc. recognized operating expenses totaling approximately $61 million and $72 million, respectively, in connection with these agreements. These amounts and the corresponding amounts recognized by the non-guarantor subsidiaries are eliminated in consolidation.

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UNAUDITED CONDENSED CONSOLIDATING BALANCE SHEETS
MARCH 31, 2002
(in thousands)

	Sabre Holdings	Sabre Inc.	Non-Guarantor Subsidiaries	Eliminating Entries	Sabre Consolidated
Assets					
Current assets					
Cash and marketable securities	$ (2,944)	$ 715,532	$ 105,288	$	$ 817,876
Accounts receivable trade, net		259,288	110,764		370,052
Intercompany accounts receivable (payable)	1,075,675	(1,406,168)	330,493		
Prepaid expenses		30,579	48,134		78,713
Deferred income taxes		44,793	87		44,880
Total current assets	1,072,731	(355,976)	594,766		1,311,521
Property and equipment, net		171,431	50,913		222,344
Deferred income taxes					
Investments in joint ventures		12,069	165,685		177,754
Goodwill and intangible assets, net		9,084	689,532		698,616
Investments in subsidiaries	462,320	1,152,801		(1,615,121)	
Other assets, net	2,970	87,847	47,615		138,432
Total assets	$ 1,538,021	$ 1,077,256	$ 1,548,511	$ (1,615,121)	$ 2,548,667
Liabilities and stockholders' equity					
Current liabilities					
Accounts payable	$	$ 143,112	$ 33,555	$	$ 176,667
		44,284	11,218		55,502

	Sabre Holdings	Sabre Inc.	Non-Guarantor Subsidiaries	Eliminating Entries	Sabre Consolidated
Accrued compensation and related benefits					
Other accrued liabilities		258,006	80,153		338,159
Total current liabilities		445,402	124,926		570,328
Deferred income taxes		47,852	(17,892)		29,960
Pensions and other postretirement benefits		103,661	820		104,481
Other liabilities	3,716	18,021	44,555		66,292
Minority interests			243,301		243,301
Notes payable	395,034				395,034
Stockholders' equity	1,139,271	462,320	1,152,801	(1,615,121)	1,139,271
Total liabilities and stockholders' equity	$ 1,538,021	$ 1,077,256	$ 1,548,511	$ (1,615,121)	$ 2,548,667

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UNAUDITED CONDENSED CONSOLIDATING BALANCE SHEETS
DECEMBER 31, 2001
(in thousands)

	Sabre Holdings	Sabre Inc.	Non-Guarantor Subsidiaries	Eliminating Entries	Sabre Consolidated
Assets					
Current assets					
Cash and marketable securities	$	$ 543,196	$ 123,691	$	$ 666,887
Accounts receivable trade, net		238,747	89,069		327,816
Intercompany accounts receivable (payable)	1,074,130	(1,406,885)	332,755		
Prepaid expenses		18,120	33,445		51,565
Deferred income taxes		45,740	230		45,970
Total current assets	1,074,130	(561,082)	579,190		1,092,238
Property and equipment, net		232,434	56,015		288,449
Investments in joint ventures		12,353	157,596		169,949
Goodwill and intangible assets, net		9,626	662,519		672,145
Investments in subsidiaries	372,556	1,132,522		(1,505,078)	
Other assets, net	5,845	76,545	70,846		153,236
Total assets	$ 1,452,531	$ 902,398	$ 1,526,166	$ (1,505,078)	$ 2,376,017
Liabilities and stockholders' equity					
Current liabilities					
Accounts payable	$	$ 136,608	$ 22,231	$	$ 158,839
Accrued compensation and related benefits		59,184	14,090		73,274
Other accrued liabilities	9,347	219,651	103,345		332,343

	Sabre Holdings	Sabre Inc.	Non-Guarantor Subsidiaries	Eliminating Entries	Sabre Consolidated
Total current liabilities	9,347	415,443	139,666		564,456
Pensions and other postretirement benefits		88,362	394		88,756
Other liabilities	1,033	26,037	33,868		60,938
Minority interests			219,716		219,716
Notes payable	400,375				400,375
Stockholders' equity	1,041,776	372,556	1,132,522	(1,505,078)	1,041,776
Total liabilities and stockholders' equity	$ 1,452,531	$ 902,398	$ 1,526,166	$ (1,505,078)	$ 2,376,017

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UNAUDITED CONDENSED CONSOLIDATING STATEMENTS OF INCOME
FOR THE THREE MONTHS ENDED MARCH 31, 2002
(in thousands)

	Sabre Holdings	Sabre Inc.	Non-Guarantor Subsidiaries	Eliminating Entries	Sabre Consolidated
Revenues	$	$ 425,492	$ 212,737	$ (98,862)	$ 539,367
Operating expenses	338	328,489	189,408	(98,862)	419,373
Operating income (loss)	(338)	97,003	23,329		119,994
Other income (expense)					
Interest income	8,536	5,722	5,249	(12,505)	7,002
Interest expense	(5,024)	(12,717)	(448)	12,505	(5,684)
Income from subsidiaries	85,296	20,278		(105,574)	
Other, net		16,406	3,482		19,888
Total other income (expense)	88,808	29,689	8,283	(105,574)	21,206
Minority interests			847		847
Income (loss) from continuing operations before income taxes	88,470	126,692	32,459	(105,574)	142,047
Provision for income taxes	1,083	41,396	12,181		54,660
Net income (loss)	$ 87,387	$ 85,296	$ 20,278	$ (105,574)	$ 87,387

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UNAUDITED CONDENSED CONSOLIDATING STATEMENTS OF INCOME
FOR THE THREE MONTHS ENDED MARCH 31, 2001
(in thousands)

Sabre Holdings	Sabre Inc.	Non-Guarantor Subsidiaries	Eliminating Entries	Sabre Consolidated

Revenues	$	$ 452,372	$ 207,896	$ (86,854)	$ 573,414
Operating expenses	172	382,185	235,124	(88,928)	528,553
Operating income (loss)	(172)	70,187	(27,228)	2,074	44,861
Other income (expense)					
Interest income	8,643	2,254	7,213	(14,589)	3,521
Interest expense		(30,417)	(365)	14,589	(16,193)
Income from subsidiaries	11,568	(27,830)		16,262	
Other, net		(2,001)	(7,707)		(9,708)
Total other income (expense)	20,211	(57,994)	(859)	16,262	(22,380)
Minority interests			7,787		7,787
Income (loss) from continuing operations before income taxes	20,039	12,193	(20,300)	18,336	30,268
Provision for income taxes	2,891	15,688	11,276		29,855
Income (loss) from continuing operations	17,148	(3,495)	(31,576)	18,336	413
Income (loss) from discontinued operations, net		15,063	643	(2,074)	13,632
Income before cumulative effect of change in accounting method	17,148	11,568	(30,933)	16,262	14,045
Cumulative effect of change in accounting method, net of minority interests and income taxes			3,103		3,103
Net income (loss)	$ 17,148	$ 11,568	$ (27,830)	$ 16,262	$ 17,148

UNAUDITED CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS
FOR THE THREE MONTHS ENDED MARCH 31, 2002
(in thousands)

	Sabre Holdings	Sabre Inc.	Non-Guarantor Subsidiaries	Eliminating Entries	Sabre Consolidated
Operating Activities					
Net earnings	$ 87,387	$ 85,296	$ 20,278	$ (105,574)	$ 87,387
Adjustments to reconcile net earnings to cash provided by operating activities:					
Depreciation and amortization		7,625	21,430		29,055
Deferred income taxes		69,317	(17,749)		51,568
Tax benefit from exercise of stock options	1,919				1,919
Minority interests			(847)		(847)
(Income) loss from subsidiaries	(85,296)	(20,278)		105,574	
Gain on sale of former headquarters building		(18,308)			(18,308)
Other		3,726	14,331		18,057
Changes in operating assets and liabilities	(9,401)	(58,625)	(18,488)		(86,514)

	Sabre Holdings	Sabre Inc.	Non-Guarantor Subsidiaries	Eliminating Entries	Sabre Consolidated
Cash provided by (used for) operating activities	(5,391)	68,753	18,955		82,317
Investing Activities					
Additions to property and equipment		(8,890)	(3,242)		(12,132)
Purchases of marketable securities		(540,795)	(119,555)		(660,350)
Sales of marketable securities		368,896	139,463		508,359
Investments in subsidiaries, net	(4,468)			4,468	
Business combinations, net of cash acquired			(35,907)		(35,907)
Proceeds from sale of former headquarters building		80,000			80,000
Proceeds from sale of minority interest in Sabre Pacific			23,466		23,466
Other investing activities, net		30,283	(6,958)		23,325
Cash provided by (used for) investing activities	(4,468)	(70,506)	(2,733)	4,468	(73,239)
Financing Activities					
Contributions from affiliates		4,468		(4,468)	
Proceeds from issuance of common stock	6,915				6,915
Other financing activities, net			(14,529)		(14,529)
Cash provided by (used for) financing activities	6,915	4,468	(14,529)	(4,468)	(7,614)
Increase (decrease) in cash	(2,944)	2,715	1,693		1,464
Cash at beginning of the period		8,642	10,213		18,855
Cash at end of the period	$ (2,944)	$ 11,357	$ 11,906	$	$ 20,319

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UNAUDITED CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS
FOR THE THREE MONTHS ENDED MARCH 31, 2001
(in thousands)

	Sabre Holdings	Sabre Inc.	Non-Guarantor Subsidiaries	Eliminating Entries	Sabre Consolidated
Operating Activities					
Net earnings	$ 17,148	$ 11,568	$ (27,830)	$ 16,262	$ 17,148
Adjustments to reconcile net earnings to cash provided by operating activities:					
Depreciation and amortization		55,798	82,557		138,355
Deferred income taxes		9,409	(9,341)		68
Minority interests			(7,787)		(7,787)
Tax benefit from exercise of stock options	6,402				6,402
(Income) loss from subsidiaries	(11,568)	27,830		(16,262)	
Cumulative effect of accounting change, net			(3,103)		(3,103)

	Sabre Holdings	Sabre Inc.	Non-Guarantor Subsidiaries	Eliminating Entries	Sabre Consolidated
Other		468	(442)		26
Changes in operating assets and liabilities	50,834	(132,499)	17,938		(63,727)
Cash provided by (used for) operating activities	62,816	(27,426)	51,992		87,382
Investing Activities					
Additions to property and equipment		(43,954)	(7,455)		(51,409)
Purchases of marketable securities		(372,125)	(83,747)		(455,872)
Sales of marketable securities		345,582	79,771		425,353
Investments in subsidiaries, net	(94,996)	(3,392)		98,388	
Business combinations, net of cash acquired			(25,000)		(25,000)
Other investing activities, net		504	(8,359)		(7,855)
Cash provided by (used for) investing activities	(94,996)	(73,385)	(44,790)	98,388	(114,783)
Financing Activities					
Contributions from affiliates		94,996	3,392	(98,388)	
Proceeds from issuance of common stock	32,180				32,180
Cash provided by (used for) financing activities	32,180	94,996	3,392	(98,388)	32,180
Increase (decrease) in cash		(5,815)	10,594		4,779
Cash at beginning of the period		1,582	6,196		7,778
Cash at end of the period	$	$ (4,233)	$ 16,790	$	$ 12,557

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

SABRE HOLDINGS CORPORATION

RESULTS OF OPERATIONS

Summary. We generate revenues from continuing operations by providing travel marketing and distribution services to travel agencies, corporate travel departments and travel suppliers using the *Sabre* system, to consumers using the Travelocity.com Web sites, to businesses using GetThere products, and from the development and marketing of airline solutions. During the three months ended March 31, 2002, we generated approximately 77.5% of our revenue from Travel Marketing and Distribution services, approximately 10.6% from Travelocity.com, 2.2% from GetThere and 9.7% from Airline Solutions. Our consolidated operating margins were 22.2% and 7.8% for the three months ended March 31, 2002 and 2001, respectively.

EDS Transaction. On July 2, 2001, we completed a transaction with EDS which provided for (i) the sale of our infrastructure outsourcing business and IT infrastructure assets and associated real estate to EDS, (ii) a 10-year contract with EDS to manage our IT systems, and (iii) agreements with EDS to jointly market IT services and software solutions to the travel and transportation industries. As a result of the EDS transaction, our financial statements have been reclassified to present the results of operations of the information technology infrastructure outsourcing business as discontinued operations for the three months ended March 31, 2001. See Note 3 to the Consolidated Financial Statements for additional information regarding this transaction.

Events of September 11, 2001. On September 11, 2001, the United States was the target of terrorist attacks of unprecedented scope involving the hijacking and destruction of multiple passenger aircraft operated by commercial air carriers. Air travel in the United States was suspended for several days after the attacks. As a consequence, we have experienced significant decreases in booking volumes due to reduced travel in the United States and, to a lesser degree, internationally. Our results of operations for the three months ended March 31, 2002 were negatively affected by this reduction in travel. Our total bookings in the U.S. were approximately 17.8% lower during the three months ended March 31, 2002 than in the year-ago period.

Three Months Ended March 31, 2002 and 2001

Revenues. Total revenues for the three months ended March 31, 2002 decreased approximately $34 million, 5.9%, compared to the three months ended March 31, 2001, from $573 million to $539 million. Travel marketing and distribution revenue decreased $43 million, 9.2%. This decrease was primarily due to a $42 million decrease in booking and other fees from associates while revenues from other services fell $1 million. Decreases in bookings were primarily the result of reduced air travel after the September 11 terrorist attacks. Travelocity.com revenues increased approximately $2 million, 3.9%, primarily as the result of a $5 million increase in other revenue and a $1 million increase in transaction services revenue. These increases were partially offset by a $4 million decline in advertising revenue. GetThere revenues increased $1 million, primarily as a result of a $3 million increase in corporate revenues. This increase was partially offset by GetThere's strategic shift away from lower margin airline fulfillment operations, resulting in a $2 million decrease in supplier revenues. Airline Solutions increased revenues approximately $6 million, 12.3%, due to increases in product and service revenues. We believe that 2002 revenues in each of our segments were adversely affected by the reduction in travel resulting from the September 11 terrorist attacks.

Cost of Revenues. Cost of revenues for the three months ended March 31, 2002 decreased approximately $73 million, 20.1%, compared to the three months ended March 31, 2001, from $363 million to $290 million. Travel marketing and distribution cost of revenues decreased $63 million,

20.9%. This decrease was driven by lower depreciation and other operating expenses. Travelocity.com cost of revenues was unchanged. GetThere cost of revenues decreased $5 million, 31.3%. This improvement was primarily attributable to workforce reductions, better leverage of employee benefits, reduced employee-related expenses including travel and incidentals, and a reduction of contract labor and services purchased. Airline solutions cost of revenues decreased $5 million, 13.5%, primarily due to lower data processing and communications expenses.

Selling, General and Administrative Expenses. Selling, general and administrative expenses for the three months ended March 31, 2002 increased $17 million, 17.2%, compared to the three months ended March 31, 2001, from $99 million to $116 million. The increase is primarily due to approximately $7 million of one-time costs resulting from the tender offer for Travelocity.com common stock, as well as costs historically allocated to the information technology outsourcing business that are still being incurred as part of continuing operations.

Amortization of goodwill and intangible assets. Amortization of goodwill and intangible assets was $14 million for the three months ended March 31, 2002, which is a $52 million reduction from the $66 million for the three months ended March 31, 2001. Goodwill and intangible assets of approximately $1 billion were recorded during 2000 in connection with the merger of Travelocity.com and Preview Travel; the acquisitions of GetThere, Gradient Solutions Limited and a 51% interest in Dillon Communications Systems; and the acquisition of Sabre Pacific in March 2001. The acquired goodwill and intangible assets were being amortized over periods ranging from one to seven years. Amortization of this goodwill and certain indefinite lived intangible assets ceased on January 1, 2002 upon our adoption of Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets,* resulting in approximately $51 million less amortization expense during the three months ended March 31, 2002. See the discussion on Recent Accounting Pronouncements in Note 2 of the Consolidated Financial Statements for information about the effect on amortization of acquired goodwill and intangible assets.

Operating Income. Operating income increased $75 million, 166.7%, from $45 million for the three months ended March 31, 2001, to $120 million for the three months ended March 31, 2002. Operating margins increased from 7.8% in 2001 to 22.2% in 2002 as the 5.9% decrease in revenues was more than offset by a 20.7% decrease in operating expenses. Travel marketing and distribution operating income increased $6 million due to reductions in depreciation and other operating expenses exceeding the revenue decreases which have resulted since the September 11 terrorist attacks. Travelocity.com operating loss decreased $19 million primarily due to increased revenues and decreased amortization of goodwill and certain indefinite lived intangible assets. GetThere operating loss

decreased $45 million primarily due to increased revenues and reductions in amortization of goodwill and certain indefinite lived intangible assets. Airline solutions operating income increased $3 million due to higher revenues with no increase in total operating expenses.

Interest Income. Interest income increased $3 million due to higher average balances maintained in our investment accounts, which was partially offset by lower average interest rates.

Interest Expense. Interest expense decreased $11 million during the three months ended March 31, 2002 due to the retirement of $859 million of debt in July 2001, primarily using cash proceeds from the sale of assets to EDS. This decrease was partially offset by interest on the $400 million Notes issued August 2001.

Other income, net. Other income, net, was $20 million during the three months ended March 31, 2002 compared to a loss of $10 million during the same period a year ago. A gain of $18 million was recorded during the three months ended March 31, 2002 as a result of the sale of our former corporate headquarters building. The loss during the three months ended March 31, 2001 consisted of unrealized losses on warrants we held to purchase shares of Hotel Reservations Network common stock.

Minority interest. The minority interest includes minority owners' interests in the results of operations of our consolidated subsidiaries, primarily Travelocity.com. The decrease in losses attributable to minority interest in first quarter 2002 relative to first quarter 2001 is due to a decrease in the net loss of Travelocity.com in 2002.

Income Taxes. The provision for income taxes was $55 million and $30 million for the three months ended March 31, 2002 and 2001, respectively. The increase in the provision for income taxes primarily corresponds with the change in income before the provision for income taxes, which is partially offset by a higher effective tax rate during 2001 resulting from non-deductible goodwill amortization during the three months ended March 31, 2001.

Income from Discontinued Operations. Net earnings from discontinued operations for the three months ended March 31, 2001 were $14 million. As noted in Note 3 to the Consolidated Financial Statements, we sold our information technology infrastructure outsourcing business to EDS effective July 1, 2001.

Cumulative Effect of Accounting Change. The cumulative effect of change in accounting method was approximately $3 million for the three months ended March 31, 2001 as a result of the adoption of Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities.* See Note 6 to the Consolidated Financial Statements for additional information.

SABRE HOLDINGS CORPORATION
LIQUIDITY AND CAPITAL RESOURCES

At March 31, 2002, we had approximately $818 million in cash and marketable securities and working capital of $741 million compared to $667 million in cash and marketable securities and working capital of $528 million at December 31, 2001. We invest cash in highly liquid instruments, including high credit quality certificates of deposit, bankers' acceptances, commercial paper, mortgage-backed and receivables-backed securities, and corporate and government notes.

Historically, we have funded our operations through internally generated cash. We generated cash from operating activities of $82 million and $87 million for the three months ended March 31, 2002 and 2001, respectively. The decrease in cash provided by operating activities during the first quarter of 2002 as compared to first quarter of 2001 primarily resulted from a decrease in revenues.

In 1999, we entered into an agreement with AOL that provides, among other things, that the Travelocity.com Web site will be the exclusive reservations engine for AOL's Internet properties. Travelocity.com is obligated for payments of up to $200 million and AOL and Travelocity.com will share advertising revenues and commissions over the five-year term of the agreement. Under certain circumstances, Travelocity.com may elect to alter the terms of this agreement such that guaranteed payments to AOL would no longer be required. If Travelocity.com chooses to alter the AOL agreement, AOL will no longer share advertising revenues with Travelocity.com. As of December 31, 2001, Travelocity.com was obligated for future payments of up to $120 million, as we have paid approximately $40 million in both 2001 and 2000. As of March 31, 2002 Travelocity.com is obligated for future payments of up to

$100 million, as we paid an additional approximately $20 million during the three months ended March 31, 2002.

We used cash for investing activities of approximately $73 million and $115 million in the three months ended March 31, 2002 and 2001, respectively. The decrease in cash used during 2002 for investing activities primarily results from decreased capital investments, proceeds from the sale of assets and repayment of a customer loan, partially offset by increased purchases of marketable securities and increased expenditures for business acquisitions.

Cash expended for business acquisitions, net of cash acquired, was approximately $36 million and $25 million during the three months ended March 31, 2002 and 2001, respectively, primarily as the result of the acquisition of Site59.com during 2002 and Sabre Pacific during 2001. We completed the

approximate $468 million acquisition of the minority interest in Travelocity.com in April 2002 using available balances of cash and marketable securities. See Note 9 to the Consolidated Financial Statements for additional discussion of this acquisition.

Capital investments for the three months ended March 31, 2002 and 2001 were $12 million and $51 million, respectively. The reduction in capital expenditures from 2001 to 2002 is due to reduced acquisitions of IT assets resulting from our IT infrastructure outsourcing services contract with EDS. We believe that future capital expenditures will be reduced as a result of the transaction with EDS.

During the third quarter of 2001, we made an unsecured $30 million loan to a customer in the travel industry. The loan was repaid to us in March 2002.

We generated approximately $7 million in cash through the sale of stock to employees during the first quarter of 2002, as compared to approximately $28 million in the year-ago period.

We had not paid any dividends on our common stock before a one-time cash dividend was paid in February 2000 in connection with our separation from AMR, nor have we paid any since. In the future, we intend to retain earnings to finance future growth and, therefore, do not anticipate paying any cash dividends on our common stock. Any determination as to the future payment of dividends will depend upon our future results of operations, capital requirements and financial condition and such other factors as our Board of Directors may consider, including any contractual or statutory restrictions on our ability to pay dividends.

We did not repurchase any of our common stock during the first quarter of 2002. As of March 31, 2002, we had authorization to spend up to an additional $56 million to repurchase our own shares. The timing, volume and price of any future repurchases will be made at the discretion of management, and will depend on corporate considerations and market conditions.

During April 2002, we completed an underwritten public offering of 9.43 million shares of Class A common stock at $44.50 per share, resulting in net proceeds to us of approximately $399.7 million. We plan to use the proceeds from the offering for general corporate purposes.

We believe available balances of cash and short-term investments, cash flows from operations and funds available under our revolving credit facility will be sufficient to meet our cash requirements for the foreseeable future. We continually evaluate opportunities to sell additional equity or debt securities, obtain credit facilities from lenders, or restructure our long-term debt for strategic reasons or to further strengthen our financial position. If market conditions warrant, we may engage in additional financing transactions. In addition, to the extent we consider additional acquisitions of or investments in complementary businesses, products, services and technologies, such additional activities might affect our liquidity requirements or cause us to issue additional equity or debt securities. We cannot assure you that financing will be available in amounts or on terms acceptable to us, if at all.

Recent Accounting Pronouncements In June 2001, the Financial Accounting Standards Board ("FASB") issued Statements of Financial Accounting Standards No. 141, *Business Combinations*, and No. 142, *Goodwill and Other Intangible Assets*, ("FAS 142") effective for fiscal years beginning after December 15, 2001. Under the new rules, goodwill and intangible assets deemed to have indefinite lives will no longer be amortized, but will be subject to annual impairment tests in accordance with the Statements. Other intangible assets will continue to be amortized over their useful lives.

We adopted the new rules on accounting for goodwill and other intangible assets beginning January 1, 2002. Application of the nonamortization provisions of FAS 142 increased first quarter net earnings by approximately $54 million, or $0.40 per share and is expected to increase net income by approximately $218 million, or $1.60 per diluted share, in 2002, as a result of the cessation of amortization of existing goodwill and certain intangibles. If FAS 142 had been applied beginning January 1, 2001 goodwill

amortization would have been reduced by approximately $51 million, or $0.38 per share, during the first quarter of 2001.

Prior to the adoption of FAS 142, our policy was to evaluate goodwill for impairment on an undiscounted projected future cash flows basis. Beginning January 1, 2002, we evaluate goodwill and indefinite lived intangible assets based on fair value. We performed the first of the required impairment tests of goodwill and indefinite lived intangible assets pursuant to FAS 142 as of January 1, 2002 and determined that no impairments were necessary.

The FASB has also recently issued FAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* ("FAS 144"), which we adopted on January 1, 2002. The FASB's new rules on asset impairment supersede FAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of* ("FAS 121"). The adoption of FAS 144 did not have a significant effect on our financial condition or results of operations. See Note 2 to the Consolidated Financial Statements for additional information pertaining to FAS 144.

OUTLOOK FOR THE REMAINDER OF 2002

This outlook section contains a number of forward-looking statements, all of which are based on our current expectations. Actual results may differ materially. Please refer to the Cautionary Statement and Risk Factors paragraphs contained below in this Management's Discussion and Analysis of Financial Condition and Results of Operations.

During the remainder of 2002, we expect the travel industry will continue to gradually recover from the impact of the attacks on September 11, 2001. We expect consolidated year-over-year revenue growth to be in the range of 1% to 5%, and expect full year earnings per share to be in the range of $1.93 to $2.03, or year-over-year growth of 12% to 18% compared to 2001, excluding certain non-cash and one-time charges in both years. The non-cash and one-time charges in 2001 include such items as amortization of goodwill and other intangible assets associated with strategic acquisitions, amortization expense associated with stock options granted to US Airways, a one-time gain from the sale of the Outsourcing Business to EDS, expenses associated with reduction in workforce, and other various special items. The non-cash and one-time charges in 2002 include such items as amortization of other intangible assets associated with strategic acquisitions, professional fees related to the tender offer for Travelocity.com, a gain on the sale of our prior headquarters building and other various special items.

We expect that the year-over-year change in revenue within the Travel Marketing and Distribution business will be in the range of (2%) to 1%. Revenue growth will be negatively impacted by the expected year-over-year decline in travel bookings, but will be partially offset by an increase in average price per booking. We expect that year-over-year revenue growth for Travelocity.com will be in the range of 20% to 30%. We expect the GetThere business to have year-over-year revenue growth in the range of 40% to 45%. We attribute this expected revenue growth to projected growth in online travel transactions by existing customers and through the addition of new clients. We anticipate flat to slight year-over-year growth within the Airline Solutions business.

SABRE HOLDINGS CORPORATION
CAUTIONARY STATEMENT

Statements in this report which are not purely historical facts, including statements regarding our anticipations, beliefs, expectations, hopes, intentions or strategies for the future, may be forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. All forward-looking statements in this report are based upon information available to us on the date of this report. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Any forward-looking statements involve risks and uncertainties that could cause actual events or results to differ materially from the events or results described in the forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements.

Risk Factors

Risks associated with an investment in our securities, and with achievement of our forward-looking statements in this report, our news releases, our Web sites, public filings, investor and analyst conferences and elsewhere, include, but are not limited to, the risk factors described below. Any of the risk factors described below could have a material adverse effect on our business, financial condition or results of operations. We may not succeed in addressing these challenges and risks.

WE FACE COMPETITION FROM ESTABLISHED AND EMERGING TRAVEL DISTRIBUTION CHANNELS. MANY OF OUR COMPETITORS IN THE TRAVEL MARKETING AND DISTRIBUTION BUSINESS ARE WELL FUNDED AND HAVE MAJOR TRAVEL SUPPLIERS AS SIGNIFICANT SHAREHOLDERS.

Our travel marketing and distribution business includes channels of distribution that target the Travel Agency, online corporate and online consumer segments of the global travel distribution market. In all of these distribution channels, we face significant competitors. In the Travel Agency channel, our *Sabre* global distribution system competes primarily against other large and well-established global distribution systems, including those operated by Amadeus, Galileo and Worldspan. In addition, we face competition in the Travel Agency channel from travel suppliers that distribute directly to Travel Agencies and from non-global distribution system companies. In the online corporate channel, our *GetThere* business competes against similar products offered by Amadeus, Galileo and Worldspan. Some of these competitors market business travel systems that are bundled with financial and other non-travel software systems that are not offered by us. In the online consumer channel, our *Travelocity.com* product offering competes not only against similar products offered by Amadeus, Galileo and Worldspan, but also with a large number of travel Web sites, including those operating by travel suppliers and by Expedia and Priceline. Airlines and other travel suppliers have significant ownership stakes in some of these competitors. Various airlines and hotels have established their own travel distribution Web sites. Several airlines and hotels have formed joint ventures that offer multi-supplier travel distribution Web sites (such as Orbitz in the United States and Opodo in Europe). Although government authorities in some jurisdictions are examining whether the content and features made available through multi-airline Web sites by their owner airlines must also be made available to competitor Web sites, and although Orbitz remains subject to review by the U.S. Departments of Justice and Transportation, it is uncertain whether the various governments will act to require carriers owning multi-airline Web sites to treat competing Web sites in a fair and non-discriminatory way. Consolidation among travel suppliers, including airline mergers and alliances, may increase competition from these supplier-related distribution channels.

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DECREASED SUPPLIER COMMISSIONS COULD ADVERSELY AFFECT US

Some travel suppliers have reduced commissions paid to Travel Agencies, which causes Travel Agencies to become more dependent on other sources of revenues, such as traveler-paid services fees and GDS-paid incentives. That may increase the use of incentive payments by global distribution systems to compete for Travel Agency business. A few travel suppliers have eliminated commissions paid to online Travel Agencies such as Travelocity.com, resulting in service fees being charged by online Travel Agencies for bookings on those suppliers. Those fees are not charged by Web sites that are related to those suppliers. Furthermore, many travel suppliers offer discounted prices when their products and services are purchased directly from a supplier-related site. Those fee and pricing differences may have the effect of diverting customers to supplier-related Web sites.

INDUSTRY CONSOLIDATION AND INCREASED COMPETITION FOR TRAVEL AGENCY SUBSCRIBERS MAY RESULT IN INCREASED EXPENSES, REDUCED REVENUE AND MARKET POSITION, AND GREATER FINANCIAL LEVERAGE.

The absolute and relative size of our Travel Agency subscriber base is important to our success. The reduction or elimination of supplier-paid commissions has forced some smaller Travel Agencies to close or to combine with larger Travel Agencies. Although we have a leading share of large Travel Agencies, competition is particularly intense among global distribution systems for larger Travel Agency subscribers. Consolidation of Travel Agencies may result in increased competition. Some of our competitors aggressively pay economic incentives to Travel Agencies to obtain business. In order to compete effectively, we may need to increase incentives, pre-pay incentives, increase spending on marketing or product development, or make significant investments to purchase strategic assets. If we do not retain subscribers representing a significant percentage of historic bookings through our global distribution system, our booking fee revenues would decrease.

AIRLINES THAT ARE DIVESTING THEIR OWNERSHIP OF GLOBAL DISTRIBUTION SYSTEMS MIGHT LIMIT THEIR PARTICIPATION IN OUR TRAVEL MARKETING AND DISTRIBUTION SERVICES.

We could be adversely affected by a decision by one or more large airlines to discontinue or to lower its level of participation in our global distribution system. Rules in the U.S., Canada, the European Union and Peru govern "computer reservation systems" such as our *Sabre* global distribution system. Airlines (such as British Airways, United Airlines, US Airways, and Continental Airlines) that divest their ownership of global distribution systems may not be subject to the rules in these jurisdictions, which would otherwise require them to participate in our global distribution system in a non-discriminatory manner. Consolidation among travel suppliers, including airline mergers, may increase competition from distribution channels related to those suppliers and place more negotiating leverage in the hands of those suppliers.

REGULATORY DEVELOPMENTS COULD LIMIT OUR ABILITY TO COMPETE.

The U.S. Department of Transportation is engaged in a comprehensive review of its rules governing "computer reservation systems" such as our *Sabre* global distribution system. It is unclear at this time when the Department of Transportation will complete its review and what changes, if any, will be made to the U.S. rules. We could be unfairly and adversely affected if the U.S. rules are retained as to traditional global distribution systems used by Travel Agencies but are not applied to travel distribution Web sites owned by more than one airline. We could also be adversely affected if changes to the U.S. rules increased our cost of doing business, weakened the non-discriminatory participation rules to allow one or more large airlines to discontinue or to lower its level of participation in our global distribution system, or caused us to be subject to rules that do not apply to our travel marketing and distribution competitors.

RAPID TECHNOLOGICAL CHANGES AND NEW DISTRIBUTION CHANNELS MAY RENDER OUR TECHNOLOGY OBSOLETE OR DECREASE THE ATTRACTIVENESS OF OUR SERVICES TO CUSTOMERS.

New distribution channels and technology in the Travel Marketing and Distribution, *GetThere* and *Travelocity.com* businesses and Airline Solutions and Emerging Businesses are rapidly emerging, such as the Internet, computer online services, private networks, cellular telephones and other wireless communications devices. Our ability to compete in those businesses, and our future results, depend in part on our ability to make timely and cost-effective enhancements and additions to our technology and to introduce new products and services that meet customer demands and rapid advancements in technology. Maintaining flexibility to respond to technological and market dynamics may require substantial expenditures and lead-time. There can be no assurance that we will successfully identify and develop new products or services in a timely manner, that products, technologies or services developed by others will not render our offerings obsolete or noncompetitive, or that the technologies in which we focus our research and development investments will achieve acceptance in the marketplace.

OUR SYSTEMS MAY SUFFER FAILURES, CAPACITY CONSTRAINTS AND BUSINESS INTERRUPTIONS, WHICH COULD INCREASE OUR OPERATING COSTS AND CAUSE US TO LOSE CUSTOMERS.

Our businesses are largely dependent on the computer data centers and network systems operated by EDS. We rely on several communications service suppliers to provide network access between our computer data center and end-users of our travel marketing and distribution and airline solutions services. We occasionally experience system interruptions that make our global distribution system or other data processing services unavailable. Much of our computer and communications hardware is located in a single facility. Our systems might be damaged or interrupted by fire, flood, power loss, telecommunications failure, break-ins, earthquakes and similar events. Computer viruses, physical or electronic break-ins and similar disruptions might cause system interruptions, delays and loss of critical data and could significantly diminish our reputation and brand name and prevent us from providing services. Although we believe we have taken adequate steps to address these risks, we could be harmed by outages in or unreliability of the data center or network systems.

OUR REVENUES ARE HIGHLY DEPENDENT ON THE TRAVEL AND TRANSPORTATION INDUSTRIES, AND PARTICULARLY ON THE AIRLINES, AND A PROLONGED SUBSTANTIAL DECREASE IN TRAVEL BOOKINGS VOLUMES COULD ADVERSELY AFFECT US.

Most of our revenue is derived from airlines, hotel operators, car rental companies and other suppliers in the travel and transportation industries. Our revenue increases and decreases with the level of travel and transportation activity and is therefore highly subject to declines in or disruptions to travel and transportation. The travel industry is seasonal, and our revenue varies significantly from quarter to quarter. Factors that may adversely affect travel and transportation activity include price escalation in travel-related industries, airline or other travel-related labor action, political instability and hostilities, inclement weather, fuel price escalation, increased occurrence of travel-related accidents, acts of terrorism, and economic downturns and recessions. We, the travel industry and the economy in general may continue to be adversely affected by the September 11, 2001 terrorist attacks on New York and Washington, and by any subsequent terrorist-related activity, particularly if any such activity involves commercial air transportation. It is not

possible to predict either the severity or duration of such decreases in the medium- or long-term. A prolonged substantial decrease in travel bookings volumes could have an adverse impact on our financial performance, operations, liquidity, or capital resources and could impair our ability to recover the carrying value of certain of our assets, including capitalized software, other intangible assets and goodwill.

WE FACE TRADE BARRIERS OUTSIDE OF NORTH AMERICA THAT LIMIT OUR ABILITY TO COMPETE.

Trade barriers erected by non-U.S. travel suppliers, who are historically often government-owned, have on occasion prevented us from offering our products and services in their markets or have denied us content or features that they give to our competitors. Those trade barriers make our products and services less attractive to Travel Agencies in those countries than products and services offered by other global distribution systems that have such capability. The potential for us to add new Travel Agency subscribers exists primarily outside of North America. Those trade barriers have restricted our ability to gain market share outside of the U.S. Competition in those countries could require us to increase incentives, reduce prices, increase spending on marketing or product development, or otherwise to take actions adverse to us.

OUR INTERNATIONAL OPERATIONS ARE SUBJECT TO OTHER RISKS WHICH MAY IMPEDE OUR ABILITY TO GROW INTERNATIONALLY.

We face risks inherent in international operations, such as risks of currency exchange rate fluctuations, local economic and political conditions, restrictive governmental actions (such as trade protection measures, including export duties and quotas and custom duties and tariffs), changes in legal or regulatory requirements, import or export licensing requirements, limitations on the repatriation of funds, difficulty in obtaining distribution and support, nationalization, different accounting practices and potentially longer payment cycles, seasonal reductions in business activity, higher costs of doing business, consumer protection laws and restrictions on pricing or discounts, lack of or the failure to implement the appropriate infrastructure to support our technology, disruptions of capital and trading markets, laws and policies of the U.S. affecting trade, foreign investment and loans, and tax and other laws. These risks may adversely affect our ability to conduct and grow business internationally.

WE MAY NOT SUCCESSFULLY MAKE AND INTEGRATE BUSINESS COMBINATIONS AND STRATEGIC ALLIANCES.

We plan to continue to enter into business combinations, investments, joint ventures or other strategic alliances with other companies in order to maintain and grow revenue and market presence. Those transactions with other companies create risks such as difficulty in assimilating the operations, technology and personnel of the combined companies; disruption of our ongoing business, including loss of management focus on existing businesses and other market developments; problems retaining key technical and managerial personnel; expenses associated with amortization of identifiable intangible assets; additional operating losses and expenses of acquired businesses; impairment of relationships with existing employees, customers and business partners; and fluctuations in value and losses that may arise from equity investments. In addition, we may not be able to identify suitable candidates for business combinations and strategic investments, obtain financing or acceptable terms for such business combinations and strategic investments or otherwise make such business combinations and strategic investments on acceptable terms.

PART II: OTHER INFORMATION

Item 1. Legal Proceedings

Worldspan Dispute

On January 9, 1998, Worldspan LP ("Worldspan"), the former provider of computer reservation system services to ABACUS International Holdings ("ABACUS"), filed a lawsuit against us in the United States District Court for the Northern District of Georgia, Atlanta Division, seeking damages and an injunction, and alleging, among other things, that we interfered with Worldspan's relationship with ABACUS, violated the U.S. antitrust laws, and misappropriated Worldspan's confidential information. On March 30, 2001, the parties filed cross motions for summary judgment on certain claims and said motions were heard by the court on

November 6, 2001. The court granted Sabre's motion for partial summary judgment dismissing Worldspan's state law claims, including alleged tortious interference and misappropriation of trade secrets. Worldspan has appealed the court's ruling. We believe that Worldspan's remaining claims are without merit and we are vigorously defending ourselves. Additionally, we are entitled to indemnification pursuant to the terms of the agreement with ABACUS. No trial date has been set.

India Tax Issue

In 1998, the Indian tax authority asserted that we have a taxable presence in India. In March 1999, we received a $30 million USD tax assessment (including interest) for the two years ending March 31, 1998. We challenged the assessment on the grounds that we do not have a taxable presence in India and, even if we do, the assessment is based on incorrect financial data. The United States government intervened on our behalf (and other U.S. companies currently facing similar tax-related issues with the Indian government) but was unable to reach agreement with the Indian government on our case. Additionally, we appealed the validity and amount of the assessment within the Indian tax authority. Although we did not prevail in our appeal based on the merits, a reassessment based on correct financial data was ordered by the tax authority. The review reduced the assessment to $2.8 million, including interest. We continue to believe that the position of the Indian government is without merit and that we will ultimately prevail. We anticipate that we will appeal the case through judicial systems in India if an unfavorable ruling is obtained from the tax authority in India.

Northwest Dispute

On June 5, 2001, Northwest Airlines ("NWA") filed a lawsuit in California District Court (San Mateo County) against Sabre Holdings Corporation and GetThere L.P. seeking 778,209 shares of Sabre Holdings Corporation Class A common stock. The California lawsuit is based on a 1999 agreement between GetThere (before we acquired it) and NWA, whereby NWA could exercise a number of warrants to obtain GetThere stock (which were converted into warrants for Sabre Holdings Corporation stock after the acquisition) if, within a certain period of time, the parties entered into certain additional agreements and GetThere began processing transactions for the NWA Web site. In March 2002, NWA, GetThere and Sabre Holdings Corporation entered into a settlement agreement with respect to this dispute.

Travelocity.com Shareholder Litigation

Sabre Holdings Corporation, its subsidiary Travelocity.com, Inc., and the directors of Travelocity.com, Inc. have been named as defendants in eleven separate lawsuits brought by twelve individual shareholders of Travelocity.com. Nine of these lawsuits were filed in the Delaware Court of Chancery in and for New Castle County on February 19, 2002 and one lawsuit was filed in the District

Court of Tarrant County, Texas on February 21, 2002 and a second suit filed in the same court on February 25, 2002. The plaintiffs generally alleged that our proposed tender offer for the publicly-held shares of Travelocity.com, which we announced on February 19, 2002, is unfair to Travelocity.com's minority shareholders, that our proposed tender offer price is inadequate, that we breached our fiduciary duties to Travelocity.com's minority shareholders, and other related allegations. On March 20, 2002, Sabre Holdings Corporation and Travelocity.com, Inc. signed a memorandum of understanding with the plaintiffs to settle all pending stockholder litigation relating to the tender offer. Under the terms of the memorandum, we have stated our intention to agree to an offer price of no less than $28 per share, and not to object to an award of attorneys' fees and costs to counsel to the putative plaintiff class in an amount not to exceed $1.9 million. Under the terms of the memorandum, the plaintiffs have stated an intention to have all pending stockholder litigation settled and dismissed as to the plaintiffs and the putative plaintiff class. The settlement is subject to, among other things, the approval of the Delaware Court of Chancery. We completed our tender offer for the publicly-held shares of Travelocity.com on April 8, 2002, and Travelocity.com became a wholly-owned subsidiary of Sabre Holdings Corporation on April 11, 2002.

Item 6. Exhibits and Reports on Form 8-K

The following exhibits are included herein:

Exhibit Number	Description of Exhibit
3.1	Restated Certificate of Incorporation of Sabre Holdings Corporation.(1)
3.2	Restated Bylaws of Sabre Holdings Corporation.(2)
12.1	

Exhibit Number	Description of Exhibit
	Computation of ratio of earnings to fixed charges for the three months ended March 31, 2002.

(1) Incorporated by reference to Exhibit 3.1 to our report on Form 10-Q for the quarter ended June 30, 2000.

(2) Incorporated by reference to Exhibit 3.2 to our report on Form 10-Q for the quarter ended June 30, 2001.

(b) Reports on Form 8-K:

On February 19, 2002, Sabre Holdings Corporation filed a report on Form 8-K announcing its intentions to make a cash tender offer for all of the outstanding publicly-held common stock of Travelocity.com, Inc. that Sabre and its subsidiaries did not already own.

On March 26, 2002, Sabre Holdings Corporation filed a report on Form 8-K raising its earnings projections for the first quarter 2002 and the full year 2002.

Pursuant to General Instruction B-2 of Form 8-K, the report on Form 8-K listed below contained only Item 9 disclosures, and consequently such Form 8-K is not incorporated into this Form 10-Q or into any other form or report filed with the Commission into which this Form 10-Q would be incorporated by reference.

On March 12, 2002, Sabre Holdings Corporation filed a report on Form 8-K announcing the publication and availability on Sabre's Web site of its newsletter for the investment community.

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Signature

Pursuant to the requirements 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.

SABRE HOLDINGS CORPORATION

Date: May 15, 2002

By: /s/ JEFFERY M. JACKSON

Jeffery M. Jackson
Executive Vice President, Chief Financial Officer and Treasurer (Principal Financial and Accounting Officer)

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

General and administrative expenses: General and administrative (“G&A”) expenses increased $22.7 million, or 30.6%, to $97.0 million for the year ended December 31, 2009, as compared to $74.2 million for the year ended December 31, 2008. G&A expenses represented 17.4% and 13.6% of total net sales for the years ended December 31, 2009 and 2008, respectively. G&A expenses increased by $7.5 million due to higher depreciation charges, and $4.1

million due to an increase in salaries, wages and benefits, primarily associated with an increased number of retail stores in operation during the year ended December 31, 2009 as compared to year ended December 31, 2008. An additional $5.1 million of the increase in G&A was due to higher professional fees related to accounting and legal services, $1.6 million related to bonuses and director stock grants and an increase of $3.0 million in fixed asset impairment charges related to underperforming retail stores scheduled for closure.

Interest expense: The major components of interest expense for the year ended December 31, 2009 consisted of interest on our revolving line of credit, loans from our CEO and unrelated parties, capital leases and our term loans. Interest rates on our various debt facilities and capital leases ranged from 5.7% to 19.3% during the year ended December 31, 2009 and 6.2% to 26.0% during the year ended December 31, 2008. Interest expense increased $8.7 million to $22.6 million for the year ended December 31, 2009, as compared to $13.9 million for the year ended December 31, 2008. Interest expense represented 4.0% and 2.6% of the total net sales for the years ended December 31, 2009 and 2008, respectively. The net increase in interest

expense was primarily attributable to the amortization of debt discount, deferred financing costs and higher borrowings under the Lion Credit Agreement as compared to our previous second lien credit facility. Additionally, $0.9 million of bank audit fees are included in interest expense for the year ended December 31, 2009, whereas no such fees were incurred in the prior year.

Other (income) expense: Other income was $(3.1) million for the year ended December 31, 2009 as compared to other expense of $0.8 million for the year ended December 31, 2008. Other income represented (0.6%) of the total net sales for the year ended December 31, 2009 as compared to other expense which represented 0.1% of the total net sales for the year ended December 31, 2008. The large change from other expense in 2008 to other income primarily relates to $2.9 million of foreign currency transaction gain.

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

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

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

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

Year Ended December 31, 2008 compared to Year Ended December 31, 2007

(Dollars in Thousands)

	2008			2007		
	Amount	% of Net Sales		Amount	% of Net Sales	
Net sales	$545,050	100.0	%	$387,044	100.0	%
Cost of sales	250,629	46.0	%	173,676	44.9	%
Gross profit	294,421	54.0	%	213,368	55.1	%
Operating expenses	258,357	47.4	%	182,246	47.1	%
Income from operations	36,064	6.6	%	31,122	8.0	%
Interest expense	13,921	2.6	%	17,541	4.5	%
Foreign currency transaction loss (gain)	621	0.1	%	(722)	(0.2	)%
Other expense (income)	155	—	%	(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 our net sales by business segment for the year ended December 31, 2008 as compared to

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the year ended December 31, 2007 (dollars in thousands):

	2008		2007			
	Amount	% of Net Sales	Amount	% of Net Sales	Change	% Change
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 %
Total net sales	$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 one store closing during the year ended December 31, 2008. In our Canada segment, during the year ended December 31, 2008, 8 retail stores were opened and one store was closed. Additionally, during the same period 44 retail stores were opened and one retail store was closed in our U.S. Retail business segment. Also of primary significance to the expansion of American Apparel's retail business in the U.S. was our increased focus on building brand awareness and targeted advertising campaigns as further described below;

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

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

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

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

International: Net sales for our International segment increased $61.9 million, or 73.2%, from $84.5 million for the year ended December 31, 2007 to $146.4 million for the year ended December 31, 2008. This
increase was primarily due to the net increase of 28 retail stores in the international segment which contributed incremental sales of $61.9 million over the prior year, from 47 retail stores as of December 31, 2007 to 75 retail stores as of December 31, 2008. Comparable store sales in the International segment increased 18.3% or $11.7 million for the year ended December 31, 2008 as compared to the year ended December 31, 2007. During 2008, we opened 29 new stores in Australia, Belgium, Brazil, China, France, Germany, Israel, Italy, Japan, Korea, Mexico, Netherlands, Spain, Switzerland and the United Kingdom. During the year ended December 31, 2008, approximately $14.5 million and $12.2 million of sales were generated by wholesale and online sales, respectively, compared with $12.6 million

and $6.6 million for wholesale and online sales, respectively, for the year ended December 31, 2007.

Cost of sales: Cost of sales as a percentage of net sales was 46.0% and 44.9% for the years ended December 31, 2008 and 2007, respectively. The increase was primarily due to the recording $12.1 million of share based compensation expense related to the stock award of approximately 1.9 million shares of common stock to manufacturing employees on August 14, 2008 and $1.1 million of employer related payroll taxes related to the stock grant in cost of sales for the year ended

December 31, 2008. The $13.2 million of expenses related to the stock award increased our cost of sales as a percentage of net sales by 2.4%. Excluding the impact of the aforementioned expenses related to the stock award, our cost of sales as a percentage of net sales decreased from 44.3% for the year ended December 31, 2007 to 43.6% for the year ended December 31, 2008. This decrease in cost of sales as a percentage of net sales was primarily due to the change in the overall sales mix during the year ended December 31, 2008 which included a higher level of retail sales as a result of the expansion of the retail business in the U.S. Retail, Canada, and International segments which generate higher gross margins than the U.S. Wholesale segment.

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

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

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

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

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

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

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

our products throughout all of its segments.

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

The number of open stores increased from 182 as of December 31, 2007 to 260 as of December 31, 2008, resulting in an

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

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

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

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

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

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

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

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

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

Prior to July 1, 2004, Old American Apparel operated as a C corporation under U.S. tax law. Effective July 1, 2004, the

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

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

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

Liquidity and Capital Resources

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

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

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

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

Cash Flow Overview

Year Ended December 31, 2009 (unaudited)

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

For the year ended December 31, 2009, we used $20.9 million of cash in investing activities. This was primarily a result of increased investment in property and equipment of $4.6 million for the U.S. wholesale, $11.2 million for the U.S. Retail, $1.4 million in the Canada segment and $3.7 million in the International segment.
For year ended December 31, 2009, cash used in financing activities was $25.5 million. This was primarily the result of using available cash and our new financing received from Lion to pay down our revolving credit facility and our

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previous term note and notes payable.

Year Ended December 31, 2008

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

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

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

Year Ended December 31, 2007

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

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

For year ended December 31, 2007, cash from financing activities was $44.5 million. This was primarily the result of $123 million cash acquired in the Acquisition, the buyout of Sang Ho Lim, the other stockholder of Old American Apparel prior to the Acquisition, of $67.9 million, decreases to the line of credit pursuant to the BofA Credit Agreement of $2.7 million, increases to the term loans and notes payable pursuant to the SOF Credit Agreement of $58.2 million offset by payments to term loans notes, payable and capital leases of $41.9 million, and distributions and advances to stockholders of $21.6 million. American Apparel’s principal capital requirements were to fund working capital needs and to finance opening of new retail stores, as well as to finance purchases of new manufacturing and information systems equipment to support higher production levels and growth in online operations.

Debt Agreements

Revolving Credit Facilities:

On July 2, 2007, we replaced our, then existing, credit facility with an increased revolving credit facility (the “BofA Agreement”) of $75 million from Bank of America, N.A (the “Bank”). Availability under the BofA Agreement, which is

secured by substantially all of our assets, is calculated by a formula referencing the amounts of accounts receivable and inventory that we maintain at any given time. The BofA Agreement also imposes certain restrictions on us regarding capital expenditures and limits our ability to, among other things, incur additional indebtedness, dispose of assets, make repayments of indebtedness or amendments of debt instruments, pay distributions, create liens on assets and enter into sale and leaseback transactions, investments, loans or advances and acquisitions.

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

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

Long-term debt and capital lease obligations:

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

Approximately $51.3 million of the proceeds of the loans made under the Lion Agreement were used by us to repay in full all outstanding principal and interest due under the SOF Credit Agreement. The remaining proceeds were used to repay $3.3 million of loans we owed to our CEO (see Note 13 to the consolidated financial statements contained elsewhere herein), to pay fees and expenses of $4.3 million that were capitalized as deferred financing costs and included in other assets in the condensed consolidated balance sheet as of December 31, 2009, and to reduce the outstanding revolver balance under the BofA Credit Agreement by $16.0 million. Accordingly, $16.0 million of the revolver balance under the BofA Credit Agreement outstanding has been refinanced on a long-term basis and as of December 31, 2008 was reclassified to long-term debt.

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

stock issuable upon exercise of the Lion Warrant, in connection with, among other things, stock dividends, subdivisions and combinations and the issuance of additional equity securities of the Company at less than fair market value.

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

the Lion Credit Agreement.

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

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

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

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

Financial Covenants

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

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

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

As of December 31, 2009, we were in compliance with all covenants and restrictions under our credit facilities. We anticipate that based on our current operating plan for the next twelve months, we will remain in compliance with the

covenants under the BofA Credit Agreement, Lion Credit Agreement and the Bank of Montreal credit facility. However, we can provide no assurances that we will maintain compliance with such covenants.

We were in compliance with the covenants under the Lion Credit Agreement as of December 31, 2009 and we anticipate that based on information currently available, we will be in compliance with the same covenants as of March 31, 2010. On March 31, 2010, the Company entered into a Second Amendment to the Lion Credit Agreement, which, among other things, increased the maximum permitted ratio Total Debt to Consolidated EBITDA (as defined in the Lion Credit Agreement) for the

four quarter period ending March 31, 2010 from 1.75:1.00 to 2.00:1.00 and for the four quarter period ending June 30, 2010 from 1.70:1.00 to 1.90:1.00. The Second Amendment will enable the Company to make additional capital investments.

Future Capital Requirements

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

Off-Balance Sheet Arrangements and Contractual Obligations

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

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

Contractual Obligations Summary

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

	Payments due by period (unaudited)				
Contractual Obligations	Total	Less than 1 year	1-3 years	4-5 years	More than 5 years
Long term debt, including interest	$110,648	$9,839	$21,600	$78,911	$298
Current debt, including interest	6,972	6,972	—	—	—
Capital lease obligations, including interest	3,183	2079	927	177	—
Operating lease obligations	460,033	67,610	126,432	114,095	151,896
Advertising commitments	3,567	3,567	—	—	—
Self insurance reserves	11,714	4,807	4,211	1,748	948
Total contractual obligations	$596,117	$94,874	$153,170	$194,931	$153,142

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

Seasonality

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

Inflation

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

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

Critical Accounting Estimates and Policies

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

Our critical accounting estimates and policies include:

- revenue recognition
- sales returns and other allowances;
- allowance for doubtful accounts;
- inventory valuation, obsolescence;
- valuation and recoverability of long-lived intangible assets including the values assigned to acquired intangible assets, goodwill, and property and equipment;
- income taxes;
- foreign currency;
- accruals for the outcome of current litigation.
- self insurance liabilities

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

- it requires assumptions to be made that were uncertain at the time the estimate was made; and
- changes in the estimate, or the use of different estimating methods that could have been selected, could have a material impact on our consolidated results of operations or financial condition.

Revenue Recognition

We recognize product sales when title and risk of loss have transferred to the customer, there is persuasive evidence of an arrangement, the sales price is fixed or determinable and collectability is reasonably assured. Wholesale product sales are recorded at the time the product is either picked up by or shipped to the customer. Online product sales are recorded at the time the products are received by the customers. Retail store sales are recorded as revenue upon the sale of product to retail customers. Our net sales represent gross sales invoiced to customers, less certain related charges for discounts, returns, and other promotional allowances and are recorded
net of sales or value added tax. Allowances provided for these items are presented in the consolidated financial statements primarily as reductions to sales and cost of sales (see “Sales Returns and Allowances” discussed below for further information).

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

Sales Returns and Allowances

We analyze sales returns in order to make reasonable and reliable estimates of product returns for our wholesale, online product sales and retail store sales based upon historical experience. We also monitor the buying patterns of the end-users of our products based on sales data received by our retail outlets. Estimates for sales returns are based on a variety of factors including actual returns based on expected return data communicated to it by customers. Accordingly, we believe that its historical returns analysis is an accurate basis for its allowance for sales returns. As with any set of assumptions and estimates, there is a range of reasonably likely amounts that may be calculated for our allowance for sales returns above. However, we

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believe that there would be no significant difference in the amounts reported using other reasonable assumptions than what was used to arrive at the allowance. We regularly review the factors that influence our estimates and, if necessary, make adjustments when we believe that actual product returns and credits may differ from established reserves. Actual experience may be significantly different than our estimates due to various factors, including, but not limited to, changes in sales volume based on consumer demand and competitive conditions. If actual or expected future returns and claims are significantly greater or lower than the allowance for sales returns established, we would record a reduction or increase to net revenues in the period in which it made such determination.

Trade Receivables and Allowance for Doubtful Accounts

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

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

Inventories

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

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

Goodwill and Other Intangible Assets

Goodwill and other intangible assets acquired in a business combination and determined to have an indefinite useful life are not amortized, but instead tested for impairment at least annually in accordance with the provisions of Accounting Standards Update ("ASC 350"), "Intangibles—Goodwill and Other". The goodwill impairment model is a two-step process. The first step compares the fair value of a reporting unit that has goodwill assigned to its carrying value. We estimate the fair value of a reporting unit by using a discounted cash flow model. If the fair value of the reporting unit is determined to be less than its carrying value, a second step is performed to compute the amount of goodwill impairment, if any. Step two allocates the fair value of the reporting unit to the reporting unit's net assets

other than goodwill. The excess of the fair value of the reporting unit over the amounts assigned to its net assets other than goodwill is considered the implied fair value of the reporting unit's goodwill. The implied fair value of the reporting unit's goodwill is then compared to the carrying value of its goodwill. Any shortfall represents the amount of goodwill impairment. We completed the annual impairment test of our goodwill as of December 31, 2009 and 2008 and determined that there was not impairment as the fair value of the reporting unit, to which goodwill was assigned, substantially exceeded the carrying value of the reporting unit.

Long-Lived Assets

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

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

We evaluate acquired assets and our retail stores for potential impairment indicators at least annually and more frequently upon the occurrence of certain events. Judgment regarding the existence of impairment indicators is based on market conditions and operational performance of the acquired businesses. Future events could cause us to conclude that impairment indicators exist, and therefore long lived assets could be impaired. Such evaluations are significantly impacted by estimates of future revenues, costs and expenses and other factors. A significant change in cash flows in the future could result in an impairment of long lived assets. During the years ended December 31, 2009, 2008 and 2007 we recorded an impairment charge in the amount of $3.3 million, $0.6 million and $0.3 million related to underperforming retail stores located in each of the U.S. Retail, Canada and International segments.

Income Taxes

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

Foreign Currency

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

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

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

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

Contingencies

We are subject to proceedings, lawsuits and other claims related to various matters. We assess the likelihood of any

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

Self insurance liabilities

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

Accounting Pronouncements-Newly Issued

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

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

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

Interest Rate Risk

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

Foreign Currency Risk

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

American Apparel, Inc.
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AND FINANCIAL STATEMENT SCHEDULE

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

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

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

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

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

Item 8. Financial Statements and Supplementary Data

American Apparel, Inc. and Subsidiaries
Consolidated Balance Sheets
(Amounts in Thousands, except par value)

	December 31, 2009 (unaudited)	2008
ASSETS		
CURRENT ASSETS:		
Cash	$9,046	$11,368
Trade accounts receivable, net of allowances of $1,763 and $1,441 at December 31, 2009 and 2008, respectively	16,907	16,439
Prepaid expenses and other current assets	9,994	5,369
Inventories	141,235	148,154
Income taxes receivable	4,494	604
Deferred income taxes	4,627	3,935
Total current assets	186,303	185,869
PROPERTY AND EQUIPMENT, net	103,310	112,408
DEFERRED INCOME TAXES	12,033	10,137
OTHER ASSETS, net	25,933	25,195
TOTAL ASSETS	$327,579	$333,609
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Cash overdraft	$3,741	$2,413
Revolving credit facilities and current portion of long-term debt	6,346	34,318
Accounts payable	19,705	32,731
Accrued expenses	30,573	22,140
Income taxes payable	2,608	8,582
Current portion of capital lease obligations	1907	2,616
Total current liabilities	64,880	102,800
LONG-TERM DEBT, net of unamortized discount of $20,537 at December 31, 2009 and none at December 31, 2008	65,997	67,050
SUBORDINATED NOTES PAYABLE TO RELATED PARTY	4,355	3,292
CAPITAL LEASE OBLIGATIONS, net of current portion	1,020	1986
DEFERRED RENT	22,052	16,011
OTHER LONG-TERM LIABILITIES	11,934	6,058
TOTAL LIABILITIES	170,238	197,197
COMMITMENTS AND CONTINGENCIES (Note 18)		
STOCKHOLDERS' EQUITY		
Preferred stock, $.0001 par value, authorized 1,000 shares; none issued	—	—
Common stock, $.0001 par value, authorized 120,000 shares; 72,467 shares issued and 71,033 shares outstanding at December 31, 2009 and 72,221 shares issued and 70,787 shares outstanding at December 31, 2008	7	7
Additional paid-in capital	150,449	131,252
Accumulated other comprehensive loss	(2,083)	(2,703)
Retained earnings	19,012	17,900
	167,385	146,456
Less: Treasury stock, 1,434 shares at cost	(10,044)	(10,044)

TOTAL STOCKHOLDERS' EQUITY	157,341	136,412
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$327,579	$333,609

See accompanying notes to consolidated financial statements.

American Apparel, Inc. and Subsidiaries
Consolidated Statements of Operations
(Amounts in Thousands, except per share amounts)

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

See accompanying notes to consolidated financial statements.

American Apparel, Inc. and Subsidiaries
Consolidated Statements of Stockholders' Equity and Comprehensive Income (Loss)
(Amounts in Thousands)

	Number of Common Shares	Par Value Amount	Treasury Stock	Additional Paid-in Capital	Due from Stockholders	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total Stockholders' Equity	Comprehensive Income (Loss)
BALANCE, January 1, 2007	48,390	$5	$—	$6,197	$ (553)	$ 361	$6,963	$ 12,973	
Outstanding shares of the Registrant at time of reverse merger dated December 12, 2007	19,933	2	—	121,587	—	—	—	121,589	
Buy out of Sang Ho Lim	(11,132)	(1)	—	(67,902)	—	—	—	(67,903)	
Repayment of stockholders advances	—	—	—	—	553	—	—	553	
Distributions to stockholders	—	—	—	(15,764)	—	—	(6,383)	(22,147)	
Reclass deferred merger costs	—	—	—	(1,003)	—	—	—	(1,003)	
Imputed interest on stockholder loans	—	—	—	577	—	—	—	577	
Capitalization of undistributed S Corporation earnings	—	—	—	12,270	—	—	(12,270)	—	
Exercise of warrants	200	—	—	1,200	—	—	—	1,200	
Cashless exercise of underwriters unit purchase options	204	—	—	—	—	—	—	—	
Net income	—	—	—	—	—		15,478	15,478	$ 15,478
Foreign currency translation, net of tax	—	—	—	—	—	504	—	504	504
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 of treasury stock	—	—	(10,044)	—	—	—	—	(10,044)	
Issuance of common stock for stock-based compensation, net of payroll tax withholding	1,105	—	—	7,452	—	—	—	7,452	
Issuance of warrants	—	—	—	1,021	—	—	—	1,021	
Net income	—	—	—	—	—	—	14,112	14,112	$ 14,112
Foreign currency translation, net of tax	—	—	—	—	—	(3,568)	—	(3,568)	(3,568)
BALANCE, December 31, 2008	72,221	7	(10,044)	131,252	—	(2,703)	17,900	136,412	$ 10,544
Issuance of common stock for stock-based compensation (unaudited)	246	—	—	525	—	—	—	525	
Issuance of warrants (unaudited)	—	—	—	18,672	—	—	—	18,672	
Net income (unaudited)	—	—	—	—	—	—	1,112	1,112	$ 1,112
Foreign currency translation, net of tax (unaudited)	—	—	—	—	—	620	—	620	620
BALANCE, December 31, 2009 (unaudited)	72,467	$7	$(10,044)	$150,449	$ —	$ (2,083)	$19,012	$ 157,341	$ 1,732

See accompanying notes to consolidated financial statements.

American Apparel, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
(Amounts in Thousands)

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

See accompanying notes to consolidated financial statements.

American Apparel, Inc. and Subsidiaries
Consolidated Statements of Cash Flows—(Continued)
(Amounts in Thousands)

	Years ended December 31,		
	2009 (unaudited)	2008	2007
RECONCILIATION OF NET INCOME TO NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES			
Net income	$1,112	$14,112	$15,478
Depreciation and amortization of property and equipment and other assets	28,151	20,844	13,306
Amortization of debt discount and deferred financing costs	7,713	1,030	583
Loss on disposal of property and equipment	246	—	—
Foreign currency transaction (gain) loss	(2,920)	621	(722)
Imputed interest on stockholder loans	—	—	577
Accrued interest – paid in kind	6,312	—	—
Retail store impairment charges	3,343	644	252
Stock-based compensation expense	525	12,625	—
Bad debt expense (recovery)	492	598	(313)
Deferred income taxes	(3,704)	(6,212)	(6,913)
Deferred rent	5,908	7,746	2,594
Changes in cash due to changes in operating assets and liabilities:			
Trade accounts receivables	(178)	(816)	(499)
Inventories	10,669	(46,361)	(21,621)
Prepaid expenses and other current assets	(4,874)	(376)	(2,298)
Other assets	(1,246)	(9,083)	(2,297)
Accounts payable	(10,297)	15,197	(16,893)
Accrued expenses and other liabilities	13,853	6,196	8,503
Income taxes receivable/payable	(9,902)	2,121	3,767
Net cash provided by (used in) operating activities	$45,203	$18,886	$(6,496)
NON-CASH INVESTING AND FINANCING ACTIVITIES			
Property and equipment acquired under a capital lease	$1,151	$1,092	$4,614
Property and equipment acquired and included in accounts payable	$764	$2,285	$1,058
Liabilities assumed under Endeavor Acquisition	$—	$—	$1,411
Reclassification of advances to stockholders	$—	$—	$553
Issuance of warrants to lender	$18,672	$1,021	$—

See accompanying notes to consolidated financial statements.

American Apparel, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(Amounts and Shares in Thousands, except per share amounts)
For the Years Ended December 31, 2009 (unaudited), 2008 and 2007
Whereas the Notes Refer to Fiscal 2009, the amounts are unauditied

1. Organization and Business
American Apparel, Inc. and its subsidiaries (collectively, "the Company") is a vertically-integrated manufacturer, distributor, and retailer of branded fashion basic apparel. The Company sells its products through the wholesale distribution channel supplying t-shirts and other casual wear to distributors and screen printers, as well as direct to customers through its retail stores located in the United States and internationally. In addition, the Company operates an online retail e-commerce website. At December 31, 2009, the Company operated a total of 281 retail stores in the United States, Canada and 18 other countries.
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.

2. Principles of Consolidation and Basis of Presentation
The consolidated financial statements include the accounts of American Apparel, Inc. and its wholly-owned subsidiaries. All intercompany accounts and transactions have been eliminated upon consolidation.

3. Summary of Significant Accounting Policies
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: revenue recognition; sales returns and allowances; allowance for doubtful accounts; inventory valuation and obsolescence; valuation and recoverability of long-lived assets, including the values assigned to property and
equipment, intangible assets and goodwill; contingencies, including accruals for the outcome of current litigation and self-insurance liabilities; income taxes; and foreign currency.
On a regular 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.

Classification and Adjustments

During 2009, the Company corrected the presentation of certain accounts and transactions in its historical financial statements as of December 31, 2008 and for the two years ended December 31, 2008, as follows:

- Workers' compensation reserves—Prior to this change, the Company's workers' compensation reserves were reported as current liabilities. However, due to the long-term nature of workers' compensation claims, which can extend over a period of years, the Company determined that the portion of reserves related to these claims that are expected to be paid beyond the Company's normal operating cycle, or 12 months after the date of the consolidated financial statements, should be classified as long-term liabilities. As a result, the Company reclassified $5,181 of workers' compensation reserves from accrued expenses, as previously reported, to other long-term liabilities on the consolidated balance sheet as of December 31, 2008. The Company also reclassified the $2,078 of deferred income tax asset balances related to the accrued workers' compensation reserves from current deferred income tax assets to noncurrent deferred income tax assets on the consolidated balance sheet as of December 31, 2008. These reclassifications had no effect on the Company's previously reported operating income, net income or cash flows, and the balance sheet reclassifications were not material to any previously reported consolidated financial statements.
- Current portion of deferred rent liability—Prior to the change, the Company's entire deferred rent liability was classified as a long-term liability. However, the portion of deferred rent which is due within the 12 months from the date of the consolidated financial statements should be classified as a short-term obligation. As a result, $1,032 of deferred rent liability was reclassified from deferred rent in non-current liabilities, as previously reported, to accrued expenses on the consolidated balance sheet as of December 31, 2008. This reclassification also resulted in a reclassification of $385 from a noncurrent deferred income tax asset to a current deferred income tax asset. These reclassifications did not impact the Company's previously reported operating income, net income or cash flows, and the balance sheet reclassifications were not material to any previously reported consolidated financial statements.
- Foreign income taxes—The Company reclassified income tax payments expected to be received by certain international subsidiaries from the respective countries' taxing authority. These amounts had previously been netted against income taxes payable related to other federal, state, and international taxes as of December 31, 2008. As a result, $604 has been reclassified from income taxes payable to income taxes receivable on the consolidated balance sheet as of December 31, 2008. This reclassification had no effect on the Company's previously reported operating income, net income or cash flows, and it is not considered material to any previously reported consolidated financial statements.
- Unrecognized tax benefits—Prior to the change, the Company recognized the unrecognized tax benefits as a current income tax payable. However, the Company has reclassified $877 from current income taxes payable, as previously reported, to other long-term liabilities on the consolidated balance sheet as of December 31, 2008. This change had no effect on the Company's previously reported operating income, net income or cash flows, and it is not considered material to any previously reported consolidated financial statements.
- Operating and investing cash flows—The Company previously did not exclude the unpaid capital expenditures recorded in accounts payable from its cash flows related to the changes in accounts payable or its capital expenditures. The Company reclassified the reported consolidated statements of cash flows for the years ended December 31, 2009 and 2008 to reflect an increase of $2,285 and $(1,058), respectively, in cash provided by (used in) operating activities and cash used in investing activities, respectively. This reclassification had no effect on the Company's previously reported operating income or net income and consolidated balance sheets and it is not considered material to any previously reported consolidated financial statements.
- Manufacturing salaries—The Company reclassified its previously reported consolidated statement of operations for the year ended December 31, 2008 and 2007 to reflect a reclassification of $4,694 and $2,105, respectively, of operating expenses to cost of sales. This reclassified certain costs charged to general and administrative accounts which consisted of activities to support the manufacturing operations of the Company. This reclassification had no effect on the Company's previously reported operating income or net income and consolidated balance sheets and it is not considered material to any previously reported consolidated financial statements.
- Certain other immaterial prior period amounts have been reclassified to conform to the current year presentation.

The following table presents the effects of these reclassifications on the Company's previously reported consolidated balance sheet, statement of operations and statement of cash flows as of December 31, 2008, for the year ended December 31, 2008 and for the years ended December 31, 2008 and 2007, respectively:

	As of December 31, 2008		
	As Reported	Reclassifications	As Revised
Assets			
Income taxes receivable	$—	$ 604	$604
Deferred income taxes—current	$5,628	$ (1,693)	$3,935
Total current assets	$186,958	$ (1,089)	$185,869
Deferred income taxes—noncurrent	$8,444	$ 1,693	$10,137
Total Assets	$333,005	$ 604	$333,609
Liabilities and Stockholders' Equity			
Accrued expenses	$26,289	$ (4,149)	$22,140
Income taxes payable	$8,855	$ (273)	$8,582
Total current liabilities	$107,222	$ (4,422)	$102,800
Deferred rent—long-term	$17,043	$ (1,032)	$16,011
Other long-term liabilities	$—	$ 6,058	$6,058
Total Liabilities	$196,593	$ 604	$197,197
Total Liabilities and Stockholders' Equity	$333,005	$ 604	$333,609

	Year ended December 31, 2008		
	As Reported	Reclassifications	As Revised
Statement of Operations			
Cost of sales	$245,935	$ 4,694	$250,629
Gross profit	$299,115	$ (4,694)	$294,421
Operating expenses	$263,051	$ (4,694)	$258,357
Statement of Cash Flows			
Cash provided by (used in) operating activities:			
Cash paid to suppliers, employees and others	$(499,184)	$ (2,285)	$(501,469)
Amortization of debt discount and deferred financing costs	$—	$ 1,030	$1,030
Accounts payable	$17,482	$ (2,285)	$15,197
Other assets	$(8,053)	$ (1,030)	$(9,083)
Net cash provided by (used in) operating activities	$21,171	$ (2,285)	$18,886
Cash used in investing activities:			
Capital expenditures	$(68,650)	$ 2,285	$(66,365)
Net cash used in investing activities	$(72,150)	$ 2,285	$(69,865)

	Year ended December 31, 2007		
	As Reported	Reclassifications	As Revised
Statement of Operations			
Cost of sales	$171,571	$ 2,105	$173,676
Gross profit	$215,473	$ (2,105)	$213,368
Operating expenses	$184,351	$ (2,105)	$182,246
Statement of Cash Flows			
Cash provided by (used in) operating activities:			
Cash paid to suppliers, employees and others	$(372,595)	$ (1,058)	$(373,653)
Amortization of debt discount and deferred financing costs	$—	$ 583	$583
Accounts payable	$(15,835)	$ (1,058)	$(16,893)
Other assets	$(1,714)	$ (583)	$(2,297)
Net cash provided by (used in) operating activities	$(5,438)	$ (1,058)	$(6,496)
Cash used in investing activities:			
Capital expenditures	$(22,195)	$ 1,058	$(21,137)

Net cash used in investing activities	$(23,795)	$ 1,058	$(22,737)

Concentration 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 (including credit card receivables), relating substantially to the Company's U.S. Wholesale segment. The Company mitigates its risk by investing through major financial institutions. The Company had approximately $7,500 and $7,675 held in foreign banks at December 31, 2009, and 2008, 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. The Company also maintains an insurance policy for certain customers based on a customer's credit rating and established limits. Collections and payments from customers are continuously monitored. As of December 31, 2009, two customers accounted for 24.7% (16.4% and 8.3%) of the Company's total accounts receivables and 33.6% (22.4% and 11.2%) of the Company's U.S. Wholesale segment accounts receivables. The Company maintains an allowance for doubtful accounts, which is based upon historical experience and specific customer collection issues that have been identified. While 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.

Goodwill and Other Intangible Assets

Goodwill represents the excess of the 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 Accounting Standards Codification ("ASC") ASC 350 – Intangibles – Goodwill and Other Intangible Assets. The Company's annual impairment test date is December 31. The goodwill impairment model is a two-step process. The first step compares the fair value of a reporting unit that has goodwill assigned to its carrying value. 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 intangible assets consist of deferred financing costs (amortized over the term of the applicable debt facility) and key money, broker and finder fees and lease rights (amortized over the life of the respective lease).

Impairment of Long-Lived Assets

The Company evaluates long-lived assets for impairment 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 measured by the difference between the carrying value and the estimated fair value of the assets, with such estimated fair values generally determined using the discounted future cash flows of the assets using a rate that approximates the Company's weighted average cost of capital. For the years ended December 31, 2009, 2008 and 2007, the Company recognized impairment charges of $3,343, $644 and $252, respectively, on assets to be held and used. The majority of the impairment charges, which related to leasehold improvements and furniture and fixtures of certain U.S. and International retail stores, are included in operating expenses in the accompanying consolidated statements of operations.

Fair Value Measurements

The Company's financial instruments are primarily composed of cash, accounts receivable (including credit card receivables), accounts payable, revolving credit borrowings, term loan, related party debt and foreign currency forward exchange contracts. The fair value of cash and cash equivalents, accounts receivable, accounts payable and revolving credit borrowings closely approximates their carrying value due to their short maturities. The fair value of the term note is estimated using a discounted cash flow analysis (see Note 12). It is not however, practical to determine the fair value of the subordinated notes payable to our CEO due to their related party nature.

The valuation techniques required by ASC 820—"Fair Value Measurements and Disclosures", are based upon observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect internal market assumptions. These two types of inputs create the following fair value hierarchy:

Level 1–Quoted prices in active markets for identical assets or liabilities.

Level 2–Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active or other inputs that are observable or can be corroborated by observable market data for

substantially the full term of the related asset or liabilities.
Level 3–Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of assets or liabilities.
ASC 820 requires the use of observable market inputs (quoted market prices) when measuring fair value and requires Level 1 quoted price to be used to measure fair value whenever possible.
The fair value of indefinite-lived assets, which consists exclusively of goodwill, is measured on a non-recurring basis in connection with the Company's annual goodwill impairment test. The fair value of the reporting unit to which goodwill has been assigned, is determined using a projected discounted cash flow analysis based on unobservable inputs including gross profit, discount rate, working capital requirements, capital expenditures, depreciation and terminal value assumptions and are classified within Level 3 of the valuation hierarchy. The Company completed the annual impairment test of its goodwill as of December 31, 2009 and 2008 and determined that there was not impairment as the fair value of the reporting unit, to which goodwill was assigned, substantially exceeded the carrying value of the reporting unit.

Web Site Development

The Company capitalizes applicable costs incurred during the application and infrastructure website development stage and expenses costs incurred during the planning and operating stage. As of December 31, 2009 and 2008, the Company had capitalized website development costs of $423 and $697, 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 workers' compensation and healthcare benefits programs. Estimated costs under the workers' compensation program, including incurred but not reported claims, are recorded as expense based upon historical experience, trends of paid and incurred claims, and other actuarial assumptions. If actual claims trends under these programs, including the severity or frequency of claims, differ from our estimates, our financial results may be significantly impacted. Our estimated self-insurance liabilities are classified in our balance sheet as accrued expenses or other long-term liabilities based upon whether they are expected to be paid during or beyond our normal operating cycle of 12 months from the date of our consolidated financial statements. Estimated costs under the healthcare program are based on estimated losses for claims incurred, but not paid at the end of the period. Funding is made directly to the providers and/or claimants by the insurance company.

Income Taxes

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 assets and liabilities 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 amounts will more likely than not go unrealized. If it becomes more likely than not that a tax asset will be realized, any related valuation allowance of 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'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 for its subsidiaries in Brazil, Canada, China, Spain, Italy and Ireland, consolidated in the Company's 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 accounts for uncertain tax positions in accordance with ASC 740—“Income Taxes”, and gross unrecognized tax benefits at December 31, 2009 and December 31, 2008 are included in other long-term liabilities in the accompanying consolidated balance sheets. The Company accrues interest and penalties, if incurred, on unrecognized tax benefits as components of the income tax provision in the accompanying consolidated statements of operations.

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 and these income taxes are not reflected in the Company's 2007 financial statements. As a result of the conversion, the Company recognized deferred tax assets and liabilities from the expected tax consequences of temporary differences between the book and tax basis of our assets and liabilities at the date of conversion into a C Corporation. This resulted in a deferred tax benefit of $6,205 being recognized and recorded as a component of the income tax benefit for the fiscal year ended December 31, 2007 in the accompanying consolidated statement of income.

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 year ended December 31, 2007. Pro forma taxes are based upon the statutory income tax rates and adjustments to income for estimated permanent differences occurring during each period. Actual rates and expenses could have differed had 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 year ended December 31, 2007.

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, and an estimate of the range of possible losses, 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. Management does not believe, based upon information available at this time, that these matters will have a material adverse effect on the Company's consolidated financial position, results of operations or cash flows. However, there is no assurance that such matters will not materially and adversely affect the Company's business, financial position, and results of operations or cash flows.

Revenue Recognition

The Company recognizes product sales when title and risk of loss have transferred to the customer, there is persuasive evidence of an arrangement, the sales price is fixed or determinable and collectability is reasonably assured.

Wholesale product sales are recorded at the time the product is either picked up by or shipped to the customer. Online product sales are recorded at the time the product is received by the customer. Retail store sales are recorded as revenue upon the sale of product 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 Other Allowances" discussed below for further information).

The Company recognizes revenue from gift cards, gift certificates and store credits as they are redeemed for product. 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 and does not reduce such liability for breakage as the Company's gift cards, gift certificates and store credits do not have expiration dates and the Company does not have sufficient historical evidence to estimate breakage. The unearned revenue for gift cards, gift certificates and store credits are recorded in accrued expenses in the accompanying consolidated balance sheets in the amount of $4,387 and

$2,672 at December 31, 2009 and 2008, respectively.

Sales Returns and Allowances

The Company analyzes sales returns in accordance with ASC 605 – "Revenue Recognition." 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 and 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.

Shipping and Handling Costs

The company incurs shipping and handling costs in its operations and accounts for such costs in accordance with ASC 605 – "Revenue Recognition". 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 and amounts billed to customers for shipping are included in net sales in the accompanying consolidated statements of operations.

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. Many 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 recognizes its minimum rent expense on a straight-line basis 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 component of deferred rent and amortized as a reduction of rent expense over the term of the related lease.

Advertising, Promotion and Catalog

The Company expenses the production costs of advertising the first time the advertising takes place. Advertising expenses for the years ended December 31, 2009, 2008 and 2007 amounted to $10,547, $18,392 and $12,765, respectively, and are included in operating expenses in the accompanying 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, 2009, 2008 and 2007, cooperative advertising expenses were $285, $258, and $377, respectively.

Pre-Opening Costs

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

Share-Based Compensation

The Company accounts for its share-based compensation in accordance with ASC 718 – "Compensation – Stock Compensation." Accordingly, the Company recognizes compensation expense equal to the fair value of vested stock awards at the time of the grant as the awards generally do not require a service period.

Foreign Currency Forward Exchange Contracts

The Company follows the provisions of ASC 820, as amended, which require the recognition of derivative instruments in the balance sheet as either an asset or liability measured at its fair value. Changes in the fair value of derivatives are to be recorded each period in comprehensive income, if the derivative is designated and effective as part of a hedge accounting transactions, or in earnings if the derivative does not qualify for hedge accounting. The Company's foreign currency forward exchange contracts do not qualify for hedge accounting and, accordingly, adjustments to fair value are recorded in foreign currency transactions (gain) loss in the consolidated statements of operations.

The Company enters into forward contracts to mitigate the cash and statement of operations impact of fluctuations in foreign currencies. At December 31, 2009 the Company did not hold any forward exchange contracts. At December 31, 2008, the Company held forward exchange contracts to purchase an aggregate notional amount of U.S. $1,700 to hedge forecasted purchases of inventory in U.S. dollars. At December 31, 2008, the fair value of the forward contracts, based on quoted market rates (level 1 in the fair value hierarchy), was $110 and is included in prepaid expenses and other current assets on the accompanying consolidated balance sheets.

Preferred stock

At December 31, 2009, 2008 and 2007, 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, 2009, 2008 or 2007. Shares may be issued in one or more series.

Earnings per Share

The Company presents earnings per share (“EPS”) in accordance with ASC 260 – “Earnings per Share”. ASC 260 requires dual presentation of basic and diluted EPS. Basic EPS includes no dilution and is computed by dividing net income 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 1, Organization and Business). 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 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.

The impact of one million shares of common stock underlying the SOF Warrant (see Note 11) is excluded from the EPS calculation because the effect would be anti-dilutive.

The Company’s net income for the periods presented in the accompanying consolidated statement of operations is available to the common stockholders. The following provides a reconciliation of weighted average shares outstanding used in calculating EPS for the years ended December 31, 2009, 2008 and 2007:

	2009 (unaudited)	2008	2007
Weighted average shares outstanding used in basic EPS	71,026	69,490	48,890
Dilutive effect of warrants and underwriters purchase option	5,838	827	524
Weighted average shares outstanding for diluted EPS	76,864	70,317	49,414

For the year ended December 31, 2009, the Company had 1,000 and 16,000 shares of common stock underlying the SOF Investments, L.P. – Private IV and Lion Warrants (as defined in Note 17), respectively.

Comprehensive Income

In accordance with ASC 220 – “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 loss are changes in equity that are excluded from the Company’s net income, specifically, unrealized gains and losses on foreign currency translation adjustments.

A reconciliation of comprehensive income for the years ended December 31, 2009, 2008 and 2007 is as follows:

	2009 (unaudited)	2008	2007
Net income, as reported	$1,112	$14,112	$15,478
Foreign currency translation adjustments, net of tax	620	(3,568)	504
Comprehensive income	$1,732	$10,544	$15,982

Accounting Standards Updates

In June 2009, the Financial Accounting Standards Board (FASB) issued its final Statement of Financial Accounting Standards (SFAS) No. 168 – The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles a replacement of FASB Statement No. 162. SFAS No. 168 made the FASB Accounting Standards Codification (the “Codification”) the single source of U.S. GAAP used by nongovernmental entities in the preparation of financial statements, except for rules and interpretive releases of the SEC under authority of federal

securities laws, which are sources of authoritative accounting guidance for SEC registrants. The Codification is meant to simplify user access to all

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authoritative accounting guidance by reorganizing U.S. GAAP pronouncements into roughly 90 accounting topics within a consistent structure; its purpose is not to create new accounting and reporting guidance. The Codification supersedes all existing non-SEC accounting and reporting standards and was effective for the Company beginning in 2009. Following SFAS No. 168, FASB will not issue new standards in the form of Statements, FASB Staff Positions, or Emerging Issues Task Force Abstracts; instead, it will issue Accounting Standards Updates. The FASB will not consider Accounting Standards Updates ("ASC") as authoritative in their own right; these updates will serve only to update the Codification, provide background information about the guidance, and provide the bases for conclusions on the change(s) in the Codification. In the description of Accounting Standards Updates that follows, references in "italic" relate to Codification Topics and Subtopics, and their descriptive titles, as appropriate.

4. Completed Merger

Upon the Merger, Dov Charney, a 50% owner of AA's Common Stock and 100% owner of CI Companies' common stock and current Chief Executive Office 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 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 was the accounting acquirer and, consequently, the Merger was 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 were 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 and comprehensive income (loss), 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 (January 1,

2007) 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.

5. 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. 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 acquisition 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 asset acquisition was accounted for under the purchase method of accounting. 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.
At December 31, 2008, the allocation of the cost to acquire these assets was 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 statements of operations.

6. Inventories
The components of inventories at December 31 are as follows:

	2009 (unaudited)	2008
Raw materials	$19,506	$41,648
Work in process	1,475	1,450
Finished goods	120,254	105,056
	$141,235	$148,154

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, 2009, 2008 and 2007, no one supplier provided more than 10% of the Company's raw material purchases.
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, 2009 and 2008, the Company had a lower of cost or market reserve for excess and slow-moving inventories of $3,116 and $2,498, respectively.
The Company establishes a reserve for inventory shrinkage for each of its retail locations. The reserve is based on the historical results of physical inventory cycle counts. The Company has a reserve for inventory shrinkage in the amount of $1,686 and $1,120 at December 31, 2009 and 2008, respectively.

7. Property and Equipment

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

	2009 (unaudited)	2008	Depreciation and Amortization Period (Years)
Machinery and equipment	$41,231	$38,556	5-7 years
Furniture and fixtures	34,356	28,408	5 years
Computers and software	24,627	19,520	3-5 years
Automobiles and light trucks	1,221	1,176	3 years
Leasehold improvements	82,565	72,840	Shorter of the life of lease or useful life
Buildings	557	2,550	25 years
Construction in progress	1933	3,861	
	186,490	166,911	
Accumulated depreciation and amortization	(83,180)	(54,503)	
Total	$103,310	$112,408	

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 Company's financial statements and the resulting gain or loss, if any, is reflected in income from operations. Property plant and equipment acquired are recorded as construction in progress until placed in-service, at which time the asset is reclassified to the appropriate asset category and depreciation commences.

For the years ended December 31, 2009, 2008, and 2007 depreciation and amortization expense relating to property and equipment (including capitalized leases) was $27,051, $20,197 and $13,033, respectively. At December 31, 2009 and 2008, property and equipment includes $12,167 and $11,370, for machinery and equipment held under capital leases, respectively. Accumulated amortization for these capital leases at December 31, 2009 and 2008 was $10,809 and $6,921, respectively.

The Company identified indicators of impairment present at certain retail stores within its U.S. Retail and International segments. Accordingly, the Company performed a recoverability test and an impairment test on these stores and determined, based on the results of an undiscounted cash flow and discounted cash flow analysis (level 3 in the fair value hierarchy), respectively, that the fair value of the assets at 19 retail stores was less than their carrying value at December 31, 2009. The Company recorded an impairment charge relating primarily to certain retail store leasehold improvements in the U.S. Retail and International segments of $3,343, $644 and $252 for the years ended December 31, 2009, 2008 and 2007, respectively, as a component of operating expenses in the consolidated statements of operations to reduce the assets carrying value to their estimated fair value.

8. Goodwill, Intangible Assets and Other 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 not impaired during the years ended December 31, 2009 and 2008.

The net carrying amounts of definite and indefinite lived intangible assets and other assets at December 31 are as follows:

	2009 (unaudited)	2008
Deferred financing costs	$7,431	$5,058
Broker and finder fees	1,763	1,656
Lease rights	2,372	1,774
Key money store leases	2,216	2,736
Gross amortizable intangible assets	13,782	11,224
Accumulated amortization	(3,476)	(1,138)
Total net amortizable intangible assets	10,306	10,086
Goodwill	1906	1906
Workers compensation deposit	1,364	314
Other	1,443	1,605
Lease security deposits	10,914	11,284
Total	$25,933	$25,195

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 $4,573, $1,030 and $583 for the years ended December 31, 2009, 2008 and 2007, respectively, which is recorded to interest expense.

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 term of the respective leases. Property lease terms are generally for ten years.

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.

Aggregate amortization expense of intangible assets and other assets (excluding deferred financing costs) is included in operating expenses in the consolidated statements of operations for the years ended December 31, 2009, 2008 and 2007 and was approximately $1,100, $647 and $273, respectively.

As of December 31, 2009, estimated amortization expense of deferred financing costs, broker and finder fees, lease rights and key money for each of the five succeeding years is as follows (unaudited):

	Amount
2010	$2,643
2011	2,553
2012	1,872
2013	1,365
2014	373

9. Accrued Expenses

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

	2009 (unaudited)	2008
Accrued compensation, bonuses and related taxes	$7,604	$5,571
Workers' compensation and other self-insurance reserves	4,807	3,252
Sales, value and property taxes	2,603	2,494
Gift cards / store credits	4,387	2,672
Other	11,172	8,151

Total	$30,573	$22,140

10. Revolving Credit Facilities and Current Portion of Long-Term Debt

Revolving credit facilities and current portion of long-term debt at December 31 consists of the following:

	2009 (unaudited)	2008
Revolving credit facility, maturing July 2012 (a)	$6,249	$49,401
Revolving credit facility, due on demand (b)	—	409
Current portion of long-term debt (see Note 11)	97	482
Amounts refinanced on long-term basis (a)	—	(15,974)
Total revolving credit facilities and current portion of long-term debt	$6,346	$34,318

The Company incurred interest charges of $22,627, $13,921 and $17,541 for the years ended December 31, 2009 and 2008, and 2007 respectively, for all outstanding borrowings and $701 was capitalized to leasehold improvements under construction at the Company's retail stores for the year ended December 31, 2009. The interest charges subject to capitalization for the years ended December 31, 2008 and 2007 was not significant.

(a) The Company has a revolving credit facility of $75,000 with Bank of America, N.A. ("BofA" and the "BofA Credit Agreement") subject to certain advance restrictions based on eligible inventory and accountsreceivable. 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" and the "SOF Credit Agreement"), as discussed in Note 11, unless the SOF Credit Agreement was refinanced on terms acceptable to BofA. On March 13, 2009, the SOF Credit Agreement was refinanced with Lion Capital (Guernsey) II Limited ("Lion"). In connection with this refinancing, the BofA Credit Agreement was amended (the "Ninth Amendment") to, among other things: (i) consent to the Lion Credit Agreement, (ii) permit certain repayments of promissory notes to our CEO and (iii) fix the maturity date at July 2, 2012. Borrowings under the BofA Credit Agreement are subject to certain advance provisions established by BofA and are collateralized by substantially all of the Company's assets.

Interest under the BoA Credit agreement is at the London Interbank Offered Rate ("LIBOR") (0.25% at December 31, 2009) plus 4.5% or BofA's prime rate (which rate can in no event be lower than LIBOR plus 4.5% per annum and was 3.25% at December 31, 2009) plus 2.5%, at the Company's option. At December 31, 2009 and 2008, the Company had $9,381 and $9,360, respectively, of outstanding letters of credit secured against the BofA Credit Agreement. Available borrowing capacity at December 31, 2009 and 2008 was $41,200 and $12,142, respectively.

Significant covenants included in the BofA Credit Agreement, as amended, include limiting the Company's capital expenditures for the combined U.S. Wholesale and U.S. Retail segments to $18,834 for fiscal 2009. The Company's actual capital expenditures for the combined U.S. Wholesale and U.S. Retail segments were $15,742. The Company was in compliance with all required covenants at December 31, 2009.

Among other provisions, the BofA Credit Agreement contains certain subjective acceleration clauses and requires that the Company maintain an arrangement similar to a traditional lockbox, and is therefore classified as a current liability. On March 13, 2009, the Company entered into the Lion Credit Agreement (see Note 11). Approximately $15,974 of the proceeds of the loans made under the Lion Credit Agreement was used by the Company to reduce the outstanding revolver balance under the BofA Credit Agreement. Accordingly, $15,974 of the revolver balance under the BofA Credit Agreement outstanding as of December 31, 2008 was reclassified to long-term debt.

(b) As of December 31, 2009, American Apparel Canada Wholesale Inc. and American Apparel Canada Retail Inc. (collectively the "CI Companies"), wholly owned subsidiaries of the Company, had a line of credit with a bank that provided for borrowings up to C$11,000 due on demand with a fixed maturity date at December 30,

2012, bearing interest at the bank's prime rate (2.25% at December 31, 2009) plus 2.00% per annum payable monthly. This line of credit is secured by moveable hypothecs, which provide for a charge on the CI Companies' accounts receivable, inventory and certain other moveable assets and by certain sections the Bank Act of Canada on inventory. Available borrowing capacity at December 31, 2009 was C$11,000.

The credit agreement contains various covenants which require the CI Companies to maintain certain financial ratios and commitments as defined by the bank. The Company was in compliance with all required covenants at December 31, 2009.

11. Long-Term Debt

The components of long-term debt at December 31 are as follows:

	2009 (unaudited)	2008
Long-term debt with Lion including accrued interest paid-in-kind of $6,130 and net of unamortized discount of $20,537 (a)(b)	$65,593	$—
Long-term debt with SOF, retired March 2009 (a)	—	51,000
Revolving credit facility portion refinanced on a long-term basis (b)	—	15,974
Other	501	558
Total long-term debt	66,094	67,532
Less current portion of debt	97	482
Long-term debt, net of current portion	$65,997	$67,050

(a) As of December 31, 2008, the Company had a term loan agreement with SOF in the amount of $51,000. Indebtedness under the SOF Credit 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 Lion. As a result of the early extinguishment of the SOF term loan, the Company wrote off $1,112 of unamortized deferred financing costs, which was included as a component of interest expense in the accompanying consolidated statement of operations. The outstanding term loan balance of $51,000 at December 31, 2008 was reflected as a long-term liability in the accompanying consolidated balance sheet, as amounts were refinanced on a long-term basis.

The covenants included in the SOF Credit Agreement were substantially similar to the covenants included in the BofA Credit Agreement (see footnote (a) in Note 10). The Company amended the SOF Credit Agreement nine times, most recently on December 19, 2008 to extend the maturity date of the loan. In connection with the ninth amendment, the Company paid SOF a fee of $2,550, which was capitalized as a deferred financing cost and fully amortized during the first quarter of 2009, and issued to SOF a warrant (the "SOF Warrant") to purchase 1,000 shares of Company common stock at an initial exercise price of $3.00 per share, subject to adjustments in certain circumstances. As a result of the issuance of the Lion Warrant, the exercise price of the SOF Warrant was adjusted to $2.816 per share (see Note 17).

(b) On March 13, 2009, the Company entered into the Lion Credit Agreement. 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 loans constituted a fee paid by the Company to Lion 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 is subordinated to the BofA Credit Agreement and contains customary representations and warranties, events of default, affirmative covenants and negative covenants (which impose restrictions and limitations on, among other things, dividends, investments, asset sales, capital expenditures and the ability of 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. At March 31, 2009 and December 31, 2009, the Company paid all accrued interest on this loan in cash while on June 30, 2009 and September 30, 2009, the Company paid all accrued interest in kind on this loan in the amount of $2,992 and $3,138, respectively. At December 31, 2009, the Company was in compliance with all required covenants under the Lion Credit Agreement.

Approximately $51,294 of the proceeds of the loans made under the Lion Credit Agreement was used by the Company to repay in full all outstanding principal and interest due under the SOF Credit Agreement. The remaining proceeds were used to repay $3,250 of loans owed by the Company to its CEO, to pay fees and

expenses of $4,276 that were capitalized as deferred financing costs and included in other assets in the accompanying consolidated balance sheet, and to reduce the outstanding revolver balance under the BofA Credit Agreement by $15,974. Accordingly, $15,974 of the revolver balance under the BofA Credit Agreement outstanding has been refinanced on a long-term basis and as of December 31, 2008 was reclassified to long-term debt.

In connection with the loans under the Lion Credit Agreement, the Company issued the Lion Warrant (see Note 17). The Company allocated the cash received from the Lion Credit Agreement between debt and warrants based on their relative fair values. The relative fair value of the debt under the Lion Credit Agreement was approximately $56,328, based on a net present value of future cash flows using a discount rate of 21.6% determined by comparable financial instruments. The Lion Warrant was recorded as a debt discount and a credit to stockholders' equity at its relative fair value of approximately $18,672. At December 31, 2009, the debt, net of unamortized discount and excluding interest paid-in-kind of $6,130, totaled approximately $59,463, and will be accreted up to the $80,000 par value of the loan using the effective interest method over the term of the Lion Credit Agreement. The Lion Warrant may be exercised by Lion by paying the exercise price in cash, pursuant to "cashless exercise" of the warrant or by a combination of the two methods. The Lion Warrant contains certain anti-dilution protections in favor of Lion providing for proportional adjustment of the warrant price and, under certain circumstances, the number of shares of the Company's common stock issuable upon exercise of the Lion Warrant, in connection with, among other things, stock dividends, subdivisions and combinations and the issuance of additional equity securities of the Company at less than fair market value.

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

12. Fair Value of Financial Instruments

The fair value of the term loans with Lion is measured on a recurring basis, in accordance with ASC 820 – "Fair Value Measurements and Disclosures", with fair value determined using a discounted cash flow analysis and a yield rate that was estimated using yield rates for publicly traded debt instruments of comparable companies with similar features. The carrying amount and fair value of the Company's term loans with Lion is presented below as of December 31, 2009 (unaudited):

	Carrying Amount	Fair Value
Long-term debt, net of discount of $20,537 and including interest paid-in-kind of $6,130 (level 2 in the fair value hierarchy)	$ 65,593	$79,889

Non-financial assets recorded at fair value on a non-recurring basis, relating to property and equipment, are discussed in Notes 3 and 7.

13. Subordinated Notes Payable to Related Party

At December 31, 2009 and 2008, the Company had outstanding loans payable to its CEO of $4,355 and $3,292, respectively. These loans bear interest at 6% and are due at various dates between December 2012 and January 2013. On February 10, 2009, our CEO loaned the Company an additional $4,000 in exchange for a promissory note. In connection with the Lion Credit Agreement entered into during March 2009, the Company repaid $3,250 of the outstanding loans payable to its CEO. For the years ended December 31, 2009, 2008 and 2007 interest expense related to these loans was $271, $346 and $277, respectively.

14. 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 19.3% (average interest rate is 11.2%).

Minimum future payments under these capital leases at December 31, 2009 (unaudited) are:

Year Ending December 31	
2010	$2,079
2011	568
2012	359
2013	177
Total future minimum lease payments	3,183
Less: amount representing interest	(256)
Net minimum lease payments	2,927
Current portion	1907
Long-term portion	$1,020

15. Income Taxes

For financial reporting purposes, income before income taxes includes the following components for the years ended December 31, 2009, 2008 and 2007

	2009 (unaudited)	2008	2007
United States	$(4,237)	$4,610	$968
Foreign	9,165	16,757	14,315
	$4,928	$21,367	$15,283

Income tax provision for the years ended December 31, 2009, 2008 and 2007 are as follows:

	2009 (unaudited)	2008	2007
Current:			
Federal	$(88)	$2,198	$92
State	2,219	1,500	641
Foreign	5,642	7,192	5,985
	7,773	10,890	6,718
Deferred:			
Federal	(3,406)	(2,579)	(5,619)
State	(197)	(987)	(1,231)
Foreign	(354)	(69)	(63)
	(3,957)	(3,635)	(6,913)
Income tax provision (benefit)	$3,816	$7,255	$(195)

The following is a reconciliation of taxes at the U.S. federal statutory rate and the effective tax rate for the years ended December 31:

	2009 (unaudited)	2008	2007
Taxes at the statutory federal tax rate of 35%	$1,725	$7,478	$5,349
Reduced federal tax rate for S Corporations	—	—	(5,124)
State tax, net of federal benefit	482	(7,817)	(3,467)
Change in valuation allowance	1,598	8,132	3,765
Change in tax rates due to conversion to C Corporation	—	980	(6,205)
Federal general business tax credits	(1,937)	(829)	—
Domestic production deduction	130	(495)	—
Foreign taxes	482	(266)	5,461
Uncertain tax positions	1,436	—	—
Other	(100)	72	26
Total income tax provision (benefit)	$3,816	$7,255	$(195)

As a result of the Merger, the Company was required to change from a Subchapter S Corporation to a C Corporation as of the Closing on December 12, 2007. 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 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.

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

	2009 (unaudited)	2008
Deferred tax assets:		
Allowance for doubtful accounts	$695	$563
Deferred rent	8,611	6,675
Accrued workers' compensation	3,901	2,980
Inventories	6,682	3,788
Accrued liabilities	3,451	620
Federal and California tax credits	20,979	18,859
Foreign currency translation loss	1,139	1948
Foreign tax credits	2,740	—
Other	1941	702
Total gross deferred tax assets	50,139	36,135
Less, valuation allowance	(20,457)	(18,859)
Net deferred tax assets	29,682	17,276
Deferred tax liabilities:		
Prepaid expenses	(3,170)	(1,580)
Fixed assets	(9,852)	(1,576)
Other	—	(48)
Total gross deferred tax liabilities	(13,022)	(3,204)
Net deferred tax assets and liabilities	$16,660	$14,072

At December 31, 2009, the Company has state net operating loss carryforwards of $686 expiring in 2018 and foreign net

operating loss carryforwards of $3,229 with expiration dates starting in 2013 (certain foreign loss carryforwards do not expire). At December 31, 2009, the Company has available California state tax credit carryforwards of $19,675 that may be utilized to offset future California tax liabilities arising in designated enterprise zone areas. The California state tax credits do not expire. The Company currently provides tax benefit for the California state tax credits as they are utilized. Management has determined that it is more likely than not that the tax credits will be unrealized due to the Company's ability to generate substantial credits in excess of credits utilized on an annual basis. Therefore, the Company has provided valuation allowances of $19,675 and $18,859 against the unused California credit carryforwards for the years ended December 31, 2009 and December 31, 2008, respectively.
On January 1, 2007, the Company adopted ASC 740-10 related to the accounting for uncertain tax positions and as a result of the adoption , the Company did not recognize any additional liabilities.
A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

	2009 (unaudited)	2008	2007
Gross unrecognized tax benefits at January 1	$937	$611	$—
Increases for tax positions in prior periods	4,052	—	—
Increases for tax positions in current period	385	326	611
Decreases for tax positions in current period	(236)	—	—
Gross unrecognized tax benefits at December 31	$5,138	$937	$611

Included in the balance of unrecognized tax benefits at December 31, 2009, 2008 and 2007 are $1,195, $0 and $0, respectively, of tax benefits that, if recognized, would affect the effective tax rate.

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, 2009. 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 concluded an audit during 2009 in Germany for 2004 through 2007. The audit resulted in a tax charge of $117 recorded in the provision for income taxes for the year ended December 31, 2009. The Company is being audited by the Canadian Revenue Agency ("CRA") for the years ended December 31, 2005 through December 31, 2007. In connection with the audit, the CRA issued a proposed adjustment disallowing certain management fees. The Company is being audited by the California Franchise Tax Board for the years ended December 31, 2007 and 2008. Until formal resolutions are reached between the Company and tax authorities, the determination of a possible audit settlement range with respect to the impact on unrecognized tax benefits is not practicable. The Company and its subsidiaries' state and foreign tax returns are open to audit under similar statute of limitations for the calendar years ended December 31, 2005 through December 31, 2009. 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, 2009 and 2008 are included in other long-term liabilities. The classification of current or noncurrent is dependent on the time period in which the Company expects the underlying issues to be resolved or the statute of limitations to expire. 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. During 2009, the Company accrued $521 of interest and $155 of penalties which are included in the accrued liabilities associated with unrecognized tax benefits. No accrual of interest and penalties was made for 2008.
The Company does not provide for U.S. Federal income taxes on the undistributed earnings ($12,318 at December 31, 2009) of its controlled foreign corporations which are considered permanently invested outside of the U.S.

16. Related Party Transactions
See "Note 13 – Subordinated Notes Payable to Related Party" for a description of the loans made by the Chief Executive Officer to the Company.

Agreements between our CEO and Lion

In connection with the Lion Credit Agreement and the Investment Agreement, dated March 13, 2009 (as amended, the "Investment Agreement"), our CEO and Lion entered into a voting agreement, dated as of March 13, 2009 (the "Investment Voting Agreement"). Pursuant to the Investment Voting Agreement, for so long as Lion has the right to designate any person or

persons to the Board of Directors, our CEO has agreed to vote his shares of common stock in favor of Lion's designees, provided that our CEO's obligation to so vote terminates if he owns less than 6,000 shares of common stock (which number will be adjusted appropriately to take into account any stock split, reverse stock split or similar transaction). In addition, pursuant to the Investment Voting Agreement, for so long as Lion has the right to designate any person or persons to the Board of Directors, Lion has agreed to vote its shares of common stock in favor of our CEO, provided that Lion's obligation to so vote terminates if either (i) our CEO beneficially owns less than 27,900 shares of common stock (which number will be adjusted appropriately to take into account any stock split, reverse stock split or similar transaction) or (ii) (A) our CEO is no longer employed on a full-time basis by the Company or any subsidiary of the Company and (B) our CEO is in material breach of the non-competition and non-solicitation covenants contained in the Acquisition Agreement (as defined below), as extended by a letter agreement, dated March 13, 2009, between our CEO and Lion.

In connection with the Lion Credit Agreement and the Investment Agreement, our CEO also agreed to extend the lock-up agreement, dated as of December 12, 2007, pursuant to which our CEO agreed not to make certain transfers of the 37,258 shares of common stock that he received pursuant to the Amended and Restated Agreement and Plan of Reorganization, dated as of November 7, 2007 (as it may be hereafter amended, supplemented or modified from time to time, the "Acquisition Agreement"), by and among the Company, American Apparel (USA), LLC (f/k/a AAI Acquisition LLC), a California limited liability company, American Apparel, Inc., a California corporation, American Apparel, LLC, a California limited liability company, the CI Companies, our CEO, each of the stockholders of the CI Companies (with respect to certain provisions of the Acquisition Agreement) and Sang Ho Lim (with respect to certain provisions of the Acquisition Agreement) from December 12, 2010 to December 31, 2013 (the "Extension Period"). However, the Extension Period will terminate upon the earliest to occur of the following events (the "Trigger Events"): (i) (A) Lion and its affiliates beneficially own less than 4,000 shares of Common Stock issued or issuable upon exercise of the Lion Warrant and (B) the loans made pursuant to the Lion Credit Agreement have been repaid in full, (ii) our CEO's employment is terminated by the Company "without cause" or (iii) our CEO terminates his employment with the Company for "good reason" (the terms "without cause" and "good reason" having the respective meanings set forth in his employment agreement, dated as of December 12, 2007, as it may be hereafter amended, supplemented or modified from time to time, between our CEO and the Company). Notwithstanding the foregoing, during the Extension Period, in addition to any other transfers permitted prior to the Extension Period, our CEO will have the right to transfer, in a single transaction or in multiple transactions from time to time, a number of shares of common stock otherwise subject to the lock-up agreement not to exceed 25% of the total number of shares of common stock in which our CEO has a legal or beneficial interest as of December 12, 2010.

In connection with the Lion Credit Agreement and the Investment Agreement, our CEO also entered into a letter agreement, dated March 13, 2009, with the Company and Lion to extend, with respect to our CEO only, the time period applicable to the non-competition and non-solicitation covenants contained in Section 5.27(a) of the Acquisition Agreement from December 12, 2011 to December 31, 2013, provided that such extension period will terminate upon the earliest to occur of the Trigger Events described above.

On October 28, 2009, the Company entered into a letter agreement among the Company, our CEO, and Lion, under which the Company and Lion agreed that notwithstanding restrictions on our CEO's ability to transfer shares of the Company's common stock that are subject to the lock-up agreement, dated December 12, 2007, our CEO has the right to pledge his right, title and interest in, to and under, in a single transaction or in multiple transactions, at any time and from time to time, an aggregate of up to 5,000 of such shares.

Personal Guarantees by the Company's CEO

The CEO of the Company has personally guaranteed the obligations of American Apparel under various property leases, including:

- New York store at 712 Broadway, New York, NY for up to approximately $820 in aggregate obligations;
- New York store at 183 E. Houston St., New York, NY for up to approximately $420 in aggregate obligations;
- New York store at 1090 Third Ave., New York, NY for up to approximately $202 in aggregate obligations;
- Chicago store at 1563 N. Milwaukee Ave., Chicago, IL for up to approximately $16 in aggregate obligations; and
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Los Angeles store at 6922 Hollywood Blvd., Los Angeles, CA for up to approximately $1,800 in aggregate obligations (equally and jointly guaranteed by the Company and our CEO).

Lease Agreement Between the Company and a Related Party

In December 2005, the Company entered into an operating lease, which commenced on November 15, 2006, for its knitting facility with a related company ("American Central Plaza, LLC"), which is partially owned by the CEO and the Chief Manufacturing Officer ("CMO") of the Company. The Company's CEO holds an 18.75% ownership interest in American Central Plaza, LLC, while the CMO holds a 6.25% interest. The remaining members of American Central

Plaza, LLC are not affiliated with the Company. The lease expires in November 2011, with a five year extension, at the option of the Company. Rent expense related to this lease was $622, $619 and $598 for the years ended December 31, 2009, 2008 and 2007, respectively.

Payments to Morris Charney

Morris Charney, father of our CEO ("Mr. M. Charney"), serves as Sole Director, President, Secretary and Treasurer of American Apparel Canada Wholesale Inc. and Sole Director, President and Secretary of American Apparel Canada Retail Inc. Day to day operations of these two Canadian subsidiaries are handled by other employees of these subsidiaries, none of whom performs any policy making functions for the Company. Management of American Apparel sets the policies for American Apparel and its subsidiaries as a whole. Mr. M. Charney provided the initial funding for the founding of American Apparel, Inc., a California corporation ("Old American Apparel"), in 1998, as well as subsequent additional financing. Such amounts were repaid by the Company during 2007. In February 2008, Mr. M. Charney was paid a onetime discretionary bonus of C$1,000 out of the bonus pool that had been set up under the Acquisition Agreement in recognition of Mr. M. Charney providing of initial funding for the founding of Old American Apparel. Mr. M. Charney does not perform any policy making functions for the Company or any of its subsidiaries. Instead, Mr. M. Charney only provides architectural consulting services primarily for stores located in Canada and, in limited cases, in the U.S. Mr. M. Charney was paid architectural consulting fees amounting to C$192, C$199 and C$146 for the years ended December 31, 2009, 2008 and 2007, respectively.

Bonus and other Payments to the CEO

The Company's employment agreement with our CEO provides for the payment of a target bonus of 150% of his annual base salary subject to certain terms and conditions. In April 2009, the Compensation Committee of the Board of Directors, after consultations with its retained compensation consultants, determined that it would be appropriate to award the CEO a discretionary bonus of $1,125, which was equal to the target level of 150% of his 2008 annual base salary, for his services for the year ended December 31, 2008. No bonus was accrued at December 31, 2008. Prior to the date that the Compensation Committee approved such bonus, the CEO advised the Compensation Committee that, in light of the Company's stock price performance in 2008, he would prefer that the Compensation Committee reduce his proposed 2008 bonus to $250 for his service for the year ended December 31, 2008. This bonus was recorded in operating expenses in the accompanying consolidated statement of operations for the year ended December 31, 2009. During the year ended December 31, 2009, the Company accrued and expensed $1,124, related to the bonus that the CEO has earned for his services provided during the year ended December 31, 2009. During the year ended December 31, 2007, the Company paid management fees to the CEO of $5,302.

17. Share-Based Compensation and Warrants

On December 12, 2007, the stockholders approved the 2007 Performance Equity Plan (as amended, the "2007 Plan"). The 2007 Plan authorizes the granting of a variety of incentive awards, the exercise or vesting of which would allow up to an aggregate of 11,000 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 to offer its employees, officers, directors and consultants whose past, present and/or potential contributions to the Company has 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, but not limited to: incentive stock options, non-qualifying stock options, reload stock options, restricted stock and stock appreciation rights. The 2007 Plan enables the compensation committee to exercise its discretion to determine virtually all terms of each grant, which allows the Company to respond to changes in compensation practices, tax laws, accounting regulations and the size and diversity of its business.

Director Grants

Each of the Company's non-employee directors are entitled to automatically receive a stock grant under the 2007 Plan for each year of Board service, such grant to be made at the beginning of each such year of service, each annual stock grant 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 first annual stock grant was approved by the Board of Directors 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 first annual stock grant; however, the number of shares awarded to each non-employee director was to be determined using the highest closing price per share of common stock as of December 12, 2007, February 6, 2008 or April 17, 2008. Consequently, the Company granted to each non-employee director approximately five shares of common stock, based upon the highest stock price being $15.60 on December 12, 2007. The compensation expense associated with the share awards of approximately $432 representing the grant date fair value on February 6, 2008 is reflected in operating expenses for the year ended December 31, 2008 in the consolidated statement of operations. Such shares were issued upon filing of the registration

statement on April 17, 2008.
On January 12, 2009, the Company issued the second annual stock grant to each non-employee director of approximately 35 shares of common stock, based upon the closing price of $2.13 per share. The expense of approximately $525 associated with the second annual grant is reflected in operating expenses for the year ended December 31, 2009 in the accompanying consolidated statement of operations.

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.

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. During the year ended December 31, 2009, the Company did not grant any stock awards under the 2007 Plan, other than to non-employee directors. As of December 31, 2009, 9,149 shares of the Company's common stock are available for future grants under the 2007 Plan. On February 16, 2010 the Company granted an additional 407 shares to employees under the 2007 Plan.

Accounting for Warrant

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"). 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 Credit Agreement from January 18, 2009 to April 20, 2009 (see Notes 10 and 11). In conjunction with this extension, the Company issued to SOF the SOF Warrant to purchase 1,000 shares of common stock for an initial exercise price of $3.00 per share, which exercise price is subject to adjustment under certain circumstances. As a result of the issuance of the Lion Warrant, the exercise price of the SOF Warrant was adjusted to $2.816 per share. The SOF Warrant has a five year term and expires on December 19, 2013. The fair value of the SOF Warrant on the date of issuance 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. In accordance with the provisions of ASC 815 – "Financial Instruments", the relative fair value assigned to the SOF Warrant of approximately $1,021 was recorded as permanent equity in additional paid-in capital in the stockholders' equity section of the consolidated balance sheet. The $1,112 million of unamortized cost related to the SOF Warrant was fully recognized as a component of interest expense during the year ended December 31, 2009.

On March 13, 2009, the Company entered into the Investment Agreement with Lion and, pursuant thereto, issued the Lion Warrant, which is exercisable at any time during its term, to purchase an aggregate of 16,000 shares of Common Stock at an exercise price of $2.00 per share, 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. The Lion Warrant contains certain anti-dilution protections in favor of Lion providing for proportional adjustment of the warrant price and, under certain circumstances, the number of shares of 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. On an as-converted basis, the shares of Common Stock issuable upon exercise of the Lion Warrant would represent approximately 18% of the outstanding shares of Common Stock. The fair value of the Lion Warrant on the date of issuance of $21,520 was determined under the Black-Scholes option pricing model. The calculation was based on a contractual term of seven years, interest rate of 2.5%, volatility of 56.5% and no dividends. In accordance with the provisions of ASC 815, the relative fair value assigned to the Lion Warrant of approximately $18,672 was recorded as permanent equity in additional paid-in capital in the stockholders' equity section of the consolidated balance sheet.

The cost related to the Lion Warrant was recorded as a discount to the related debt and will be recognized as interest expense using the effective interest method over the term of the Lion Credit Agreement.

Stock Repurchases

On May 23, 2008, the Company 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, 2009 and 2008, the Company had repurchased 1,434 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.

18. Commitments and Contingencies

Operating Leases

The Company conducts retail operations under operating leases, which expire at various dates through September 2022. The Company's primary manufacturing facilities and executive offices are currently under a long-term lease which expires on July 31, 2019. 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, 2009 (unaudited) are as follows:

	Amount
2010	$67,610
2011	64,893
2012	61,539
2013	59,381
2014	54,714
Thereafter	151,896
Total	$460,033

Operating lease rent expense (including real estate taxes and maintenance costs) and leases on a month to month basis were approximately $79,293, $59,205, and $38,171 for the years ended December 31, 2009, 2008 and 2007, respectively. The Company did not incur any significant contingent rent during the same periods. Rent expense is allocated to cost of sales (for production-related activities) and operating expenses (primarily for retail stores) in the accompanying consolidated statements of operations.

Sales Tax

The Company sells its products through its wholesale business, retail stores and the internet. The Company operates these channels separately and accounts for sales and use tax accordingly. The Company is periodically audited by state taxing authorities and it is possible they may disagree with the Company's method of assessing and remitting these taxes. The Company believes that it properly assesses and remits all applicable state sales taxes in the applicable jurisdictions and has accrued approximately $1,371 and $930 as of December 31, 2009 and 2008, respectively, for state sales tax contingencies that require recognition under ASC 450 – "Contingencies".

Advertising

At December 31, 2009, the Company had approximately $3,567 in open advertising commitments, which primarily relate to print advertisements in various newspapers and magazines during the remainder of 2010.

U.S. Immigration and Customs Enforcement

On January 3, 2008, representatives of U.S. Immigration and Customs Enforcement ("ICE") conducted an inspection to determine the Company's compliance with Section 274A of the Immigration and Nationality Act.

On June 24, 2009, ICE notified the Company that it was unable to verify the employment eligibility of approximately 200 current employees because of discrepancies in these employees' records. Additionally, ICE notified the Company

that another approximately 1,600 current employees appeared not to be authorized to work in the United States and appeared to have

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obtained employment by providing, on Form I-9, documentation which ICE believes, based on its proprietary databases, to be suspect and not valid. ICE's notification provided no indication that the Company knowingly or intentionally hired unauthorized aliens and no criminal charges have been filed against the Company or any current employees.

The Company terminated the employment of those persons identified by ICE who were not able to resolve the discrepancies in their work records, or present valid identification and employment eligibility documents. In the fourth quarter of 2009, as a result of the inspection, the Company was fined by ICE for an amount that was deemed immaterial, and the amount was accrued in the accompanying consolidated balance sheet as of December 31, 2009. It is the Company's policy to fully comply with its obligations to establish the employment eligibility of prospective employees under immigration laws.

19. Workers' Compensation and Other Self-Insurance Reserves

The Company uses a combination of third-party insurance and/or self-insurance for a number of risks including workers' compensation, medical benefits provided to employees, and general liability claims. General liability costs relate primarily to litigation that arises from store operations. Self-insurance reserves include estimates of both filed claims 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 of 5% with a duration that approximates the duration of the Company's self-insurance reserve portfolio. The Company's liability reflected on the consolidated balance sheets represents an estimate of the ultimate cost of claims incurred as of the balance sheet dates. 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 the end of the period. 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, 2009 and 2008, the Company has issued standby letters of credit under the BofA Credit Agreement in the aggregate amount of $7,125 and $7,190, respectively, with two insurance companies being the beneficiaries. At December 31, 2009, the Company recorded a total reserve of $9,953, of which, $3,046 is included in accrued expenses and $6,907 is included in other long-term liabilities on the accompanying consolidated balance sheets. At December 31, 2008, the Company recorded a total reserve of $7,433, of which, $2,252 is included in accrued expenses and $5,181 is included in other long term liabilities on the accompanying consolidated balance sheets. These reserves for potential losses on existing claims are believed to be for potential losses which are probable and reasonably estimable. The increase in the workers' compensation reserve is a result of the increase in claims.

The medical benefit liability is based on estimated losses for claims incurred, but not paid at the end of the period. Funding is made directly to the providers and/or claimants by the insurance company. At December 31, 2009 and 2008, the Company's total reserve of $1,761 and $491 was included in accrued expenses in the accompanying consolidated balance sheets.

20. Business Segment and Geographic Area Information

The Company reports the following four operating segments: U.S. Wholesale, U.S. Retail, Canada, and International. All of the Company's sales fall into one of these reportable segments. The Company believes this method of segment reporting reflects both the way its business segments are managed and the way the performance of each segment is evaluated. The U.S. Wholesale segment consists of the Company's wholesale operations in the U.S. of sales of undecorated apparel products to distributors and third party screen printers, as well as the Company's online consumer sales to U.S. customers. The U.S. Retail segment consists of the Company's retail operations in the U.S., which was

comprised of 160 retail stores operating in the U.S., as of December 31, 2009. The Canada segment includes retail, wholesale and online consumer operations in Canada.

As of December 31, 2009, the retail operations in the Canada segment were comprised of 40 retail stores. The International segment includes retail, wholesale and online consumer operations outside of the U.S. and Canada. As of December 31, 2009, the retail operations in the International segment were comprised of 81 retail stores operating outside of the U.S. and Canada in 18 countries. All of the Company's retail stores sell the Company's apparel products directly to consumers.

The Company's management evaluates performance based on a number of factors; however, the primary measures of performance are net sales and income or loss from operations of each business segment, as these are the key performance indicators reviewed by management. Operating income or loss for each segment does not include unallocated 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, finance, information technology, accounting, executive compensation and various other corporate level 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. Intercompany charges related to transfer pricing are eliminated in consolidation from cost of sales of the Canada and International segments and were $5,306 and $15,750, respectively, for the year ended December 31, 2008, while intercompany sales eliminated in consolidation from the U.S. wholesale segment amounted to $21,056 for the same period. The accounting policies of all operating segments are the same as those described in the summary of significant accounting policies.

The following table represents key financial information of the Company's reportable segments before unallocated corporate expenses:

	For the Year ended December 31, 2009 (unaudited)				
	U.S. Wholesale	U.S. Retail	Canada	International	Consolidated
Net sales to external customers	$141,521	$191,325	$68,983	$ 156,946	$ 558,775
Gross profit	36,214	136,424	43,242	104,032	319,912
Income from segment operations	15,541	17,340	13,999	15,312	62,192
Depreciation and amortization	8,992	11,286	1,083	6,790	28,151
Capital expenditures	4,558	11,184	1,392	3,755	20,889
Deferred rent expense	357	3,541	413	1,597	5,908
	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	21,144	127,936	45,378	99,963	294,421
Income from segment operations	(36)	33,483	16,060	23,735	73,242
Depreciation and amortization	7,141	6,974	2,409	4,320	20,844
Capital expenditures (including business acquisition)	17,386	29,515	4,701	18,263	69,865
Deferred rent expense	262	4,042	321	3,121	7,746
	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 segment operations	19,743	24,756	1,522	14,795	60,816
Depreciation and amortization	4,927	4,395	1983	2001	13,306
Capital expenditures (including business acquisition)	5,185	8,429	1984	7,139	22,737
Deferred (benefit) rent expense	(155)	2030	180	539	2,594

Reconciliation of reportable segments combined income from operations for the years ended December 31, 2009, 2008 and 2007 to the consolidated income before income taxes is as follows:

	2009 (unaudited)	2008	2007
Consolidated income from operations of reportable segments	$62,192	$73,242	$60,816
Corporate expenses	(37,777)	(37,178)	(29,694)

Interest expense	(22,627)	(13,921)	(17,541)
Other income (expense)	220	(155)	980
Foreign currency gain (loss)	2,920	(621)	722
Consolidated income before income taxes	$4,928	$21,367	$15,283

Net sales by each reportable segment's class of customer and geographic location of customer for the years ended December 31, 2009, 2008 and 2007 consist of the following:

	Years Ended December 31,		
	2009 (unaudited)	2008	2007
U.S. Wholesale			
Wholesale	$118,241	$137,185	$125,609
Online consumer	23,280	25,483	18,869
Total	$141,521	$162,668	$144,478
U.S. Retail	$191,325	$168,653	$115,615
Canada			
Wholesale	$11,442	$12,708	$11,335
Retail	55,971	52,872	30,068
Online consumer	1,570	1,700	1,004
Total	$68,983	$67,280	$42,407
International			
Wholesale	$12,368	$14,510	$12,631
Retail	132,092	119,749	65,297
Online consumer	12,486	12,190	6,616
Total	$156,946	$146,449	$84,544
Consolidated			
Wholesale	$142,051	$164,403	$149,575
Retail	379,388	341,274	210,980
Online consumer	37,336	39,373	26,489
Total	$558,775	$545,050	$387,044
Net sales by geographic location of customer:			
United States	$332,846	$331,322	$260,093
Canada	68,982	67,280	42,407
Europe (excluding United Kingdom)	81,252	74,297	45,100
United Kingdom	34,214	35,653	17,647
Korea	9,443	10,453	9,186
Japan	14,122	14,909	9,840
Australia	9,105	5,901	420
Other foreign countries	8,811	5,235	2,351
Total Consolidated Net Sales	$558,775	$545,050	$387,044

Long-lived assets—property and equipment, net by geographic location, is summarized as follows as of December 31:

	2009	2008
United States	$71,451	$79,286
Canada	8,767	7,251
Europe (excluding the United Kingdom)	9,987	12,682
United Kingdom	6,292	6,439
Korea	632	703
Japan	2,827	3,278
Australia	1,299	1,021
Other foreign countries	2055	1,748
Total consolidated long-lived assets	$103,310	$112,408
Identifiable assets by reportable segment:		
US Wholesale	$153,654	$178,060
US Retail	119,417	98,947
Canada	17,523	17,112
International	36,985	39,490
Total	$327,579	$333,609

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

	2009 (unaudited)		2008	
Total Assets	30.8	%	15.1	%
Total Liabilities	17.1	%	14.5	%

21. 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. In addition to the estimated loss, the recorded liability includes probable and estimable legal costs associated with the claim or potential claim. We currently do not believe, based upon information available at this time, that these matters will have a material adverse effect on our consolidated financial position, results of operations or cash flows. However, there is no assurance that such matters will not materially and adversely affect the Company’s business, financial position, and results of operations or cash flows.

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 (Mary Nelson v. American Apparel, Inc., et al., 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 the Company. The Company denies all of Ms. Nelson’s allegations of wrongdoing. Ms. Nelson is seeking unspecified monetary damages and costs. The trial has been stayed, and the Court of Appeal of the State of California has reversed the Superior Court’s denial of the Company’s motion to compel arbitration pursuant to an agreement among the parties. On January 14, 2009, the California Supreme Court denied a petition filed by Ms. Nelson, requesting the California Supreme Court to review the California Appellate Court order compelling Ms. Nelson to arbitrate the Company’s claims against her for breaches of a settlement agreement. Ms. Nelson has now exhausted all of her appeals. In May 2009, Ms. Nelson filed a
Demand for Arbitration before JAMS (Judicial Arbitration and Mediation Services), whereby she asserts the following causes of action: Breach of Agreement, Breach of Contract, Failure to Pay Settlement Monies, Fraud in the Inducement, and Disparagement. On August 28, 2009, the Company filed its answer and counterclaims for breach of

contract against Ms. Nelson. 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. The Company intends to aggressively defend any allegations of wrongdoing.

On February 7, 2006, Sylvia Hsu, a former employee of the Company, 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 a 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 the Company 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. Approximately half of these interviews have been concluded, with the second half to be conducted at a future time to be determined. Given the broad scope of the EEOC's investigation, it is impossible to predict with any degree of accuracy how this matter will develop, how it will be resolved, what remedies or relief, if any, will be sought or what the impact might be on the Company. The Company 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 sought monetary damages in an amount he believed 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. On May 18, 2009, the Company, through its insurance carrier, agreed to a settlement with Mr. Allen prior to the commencement of the trial. The monetary amount that the Company contributed to the overall settlement was deemed immaterial and was recorded as a component of operating expenses in the accompanying consolidated statement of operations during the year ended December 31, 2009.

On November 5, 2009, Guillermo Ruiz, a former employee of the Company, filed suit against the Company on behalf of putative classes of current and former non-exempt California employees (Guillermo Ruiz, on behalf of himself and all others similarly situation v. American Apparel, Inc., Case Number BC425487) in the Superior Court of the State of California for the County of Los Angeles, alleging the Company failed to pay certain wages due for hours worked, to provide meal and rest periods or compensation in lieu thereof and to pay wages due upon termination to certain of its employees. The complaint further alleges that the Company failed to comply with certain itemized employee wage statement provisions and unfair competition law. The plaintiff is seeking compensatory damages and economic and/or special damages in an unspecified amount; premium pay, wages and penalties; injunctive relief and restitution; and reimbursement for attorneys' fees, interest and the costs of the suit. On December 22, 2009, the parties filed a written stipulation with the Court setting forth the parties' agreement to stay this matter for approximately six months, during which the parties will mediate Plaintiff's claims. In the event mediation is unsuccessful, the parties have agreed to submit this matter to binding arbitration. The Company does not have insurance coverage for this matter. Should the matter be decided against the Company, the Company could not only incur substantial liability but also experience an increase in similar suits and suffer reputational harm. The Company is unable to predict the financial outcome of this matter at this time, and any views formed as to the viability of this claim or the financial exposure in which it could result may change from time to time as the matter proceeds through its course. No assurance can be made that this matter either individually or together with the potential for similar suits and reputational harm, will not result in a material financial exposure, which could have a material adverse effect upon our financial condition and results of operations.

The Company is currently engaged in other employment-related claims and other matters incidental to the Company's business. Management believes that all such claims against the Company are without merit or not material, and the Company intends 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, the Company believes the amount, and ultimate liability, if any, with respect to these actions will not materially affect the Company's business, financial position, results of operations, or cash flows. The Company cannot assure you, however, that such actions will not have a material adverse effect on the Company's consolidated results of operations, financial position or cash flows.

Schedule II
American Apparel, Inc. and Subsidiaries
Valuation and Qualifying Accounts

Description	Balance at Beginning of Year	Charged to costs and Expenses	Deductions (recoveries)	Other	Balance at End of Year
Allowance for trade accounts receivable:					
For the year ended December 31, 2009 (unaudited)	$1,441	$572	$(220)	$(30) [1]	$1,763
For the year ended December 31, 2008	$1,876	$598	$—	$(1,033) [1]	$1,441
For the year ended December 31, 2007	$2,189	$—	$(313)	$—	$1,876

[1] Foreign exchange rate fluctuation

Supplementary Financial Information

The following quarterly data are derived from the Company's consolidated statements of operations.

QUARTERLY INFORMATION (unaudited)

(Amounts in thousands except per share amounts)

	Quarter Ended December 31, 2009	Quarter Ended September 30, 2009	Quarter Ended June 30, 2009	Quarter Ended March 31, 2009	Year Ended December 31, 2009
Fiscal 2009					
Net sales	$ 158,111	$ 150,319	$136,061	$114,284	$ 558,775
Gross profit	$ 87,016	$ 87,285	$80,214	$65,397	$ 319,912
Net income (loss)	$ 3,049	$ 4,160	$4,462	$(10,559)	$ 1,112
Earnings (loss) per share-basic	$ 0.04	$ 0.06	$0.06	$(0.15)	$ 0.02
Earnings (loss) per share-diluted	$ 0.04	$ 0.05	$0.06	$(0.15)	$ 0.01
	Quarter Ended December 31, 2008	Quarter Ended September 30, 2008	Quarter Ended June 30, 2008	Quarter Ended March 31, 2008	Year Ended December 31, 2008
Fiscal 2008					
Net sales	$ 145,644	$ 154,801	$132,971	$111,634	$ 545,050
Gross profit	$ 79,410	$ 76,076	$77,956	$60,979	$ 294,421
Net income	$ 3,884	$ 2,333	$6,791	$1,104	$ 14,112
Earnings per share-basic	$ 0.05	$ 0.03	$0.10	$0.02	$ 0.20
Earnings per share-diluted	$ 0.05	$ 0.03	$0.10	$0.02	$ 0.20

Seasonality

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

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosures

On April 3, 2009, the Company's audit committee dismissed Marcum LLP ("Marcum"), formerly Marcum & Kliegman LLP, as the Company's independent registered public accounting firm. The decision to change independent registered public accounting firms was not the result of any disagreement between the Company and Marcum on any matters of accounting principles or practices, financial statement disclosure, or auditing scope or procedure. The audit reports of Marcum with respect to the consolidated financial statements as of and for the fiscal years ended December 31, 2008 and 2007 did not contain any adverse opinion or disclaimer of opinion, nor were they qualified or modified as to uncertainty or audit scope.
On April 3, 2009, the Company's audit committee engaged Deloitte & Touche LLP ("D&T") as its independent registered public accounting firm to audit its financial statements for the year ended December 31, 2009. During the Company's two most recent years ended December 31, 2008 and subsequent interim period through April 3, 2009, the Company did not consult with D&T with respect to the application of accounting principles to a specified transaction, either completed or proposed, or the type of audit opinion that might be rendered on the Company's consolidated financial statements or any other matters or reportable events as set forth in Items 304 (a) (2) (i) and (ii) of Regulation S-K.

Effective July 22, 2010, D&T resigned as the independent registered public accounting firm of the Company. D&T served as the Company's independent registered public accounting firm since April 3, 2009.

During the period from April 3, 2009 through July 22, 2010, the Company had no disagreements with D&T on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure that, if not resolved to D&T's satisfaction, would have caused D&T to make reference to the subject matter thereof in connection with its report on the Company's consolidated financial statements for the year ended December 31, 2009.

D&T's audit report dated March 31, 2010 (which was included in the Company's Annual Report on Form 10-K for the year ended December 31, 2009, filed with the SEC on March 31, 2010 (the "2009 Form 10-K") on the Company's consolidated financial statements as of, and for the year ended, December 31, 2009 did not contain an adverse opinion or a disclaimer of opinion, nor was it qualified or modified as to uncertainty, audit scope, or accounting principles.

During the period from April 3, 2009 through July 22, 2010, there were no "reportable events" (as defined in Item 304(a)(1)(v) of Regulation S-K), except that (i) in D&T's report dated March 31, 2010 (which was included in the 2009 Form 10-K) on the Company's internal control over financial reporting as of December 31, 2009, D&T identified material weaknesses in internal control over financial reporting related to the control environment and to the financial closing and reporting process, which are further described under Item 9A in the Company's 2009 Form 10-K, and advised that the Company has not maintained effective internal control over financial reporting as of December 31, 2009; and (ii) D&T advised the Company that certain information had come to D&T's attention, that if further investigated might materially impact the reliability of either its previously issued audit report or the underlying consolidated financial statements for the year ended December 31, 2009 included in the Company's 2009 Form 10-K. D&T requested that the Company provide D&T with the additional information D&T believed was necessary to review before the Company and D&T could reach any conclusions as to the reliability of the previously issued consolidated financial statements for the year ended December 31, 2009 and auditors' report thereon.

The Audit Committee of the Board of Directors of the Company discussed each of these matters with D&T. The Company authorized D&T to respond fully to the inquiries of the Company's successor accountants concerning each of these matters.

On July 26, 2010, the Audit Committee engaged Marcum as the Company's independent auditors to audit the Company's financial statements. During the fiscal years ended December 31, 2008 and 2009, and the subsequent interim period from January 1, 2010 through July 26, 2010, the Company has not, and no one on the Company's behalf

has, consulted with Marcum on any of the matters or events set forth in Item 304(a)(2) of Regulation S-K, except that (i) Marcum audited the Company's consolidated financial statements as of, and for the year ended, December 31, 2008, (ii) Marcum expressed an adverse opinion on the effectiveness of the Company's internal control over financial reporting as described in the Company's Amendment No. 1 to Current Report on Form 8-K/A filed with the SEC on April 10, 2009, (iii) the Company discussed certain matters with Marcum as described in the Company's Current Report on Form 8-K filed with the SEC on July 23, 2009, (iv) Marcum reissued its auditors' report, dated August 12, 2009, in conjunction with the Company's Amendment No. 1 to its Annual Report on Form 10-K for the year ended December 31, 2008, filed with the SEC on August 13, 2009, and the 2009 Form 10-K, (v) Marcum performed related auditing, review and updating procedures during the time period that Marcum was terminated as the Company's independent registered public accounting firm, effective April 3, 2009, and the date that Marcum was reappointed on July 26, 2010.

On December 10, 2010, at the Company's 2010 Annual Meeting of Stockholders, Marcum was ratified as the Company's independent auditors for the fiscal year ending December 31, 2010. In connection with the ratification, the Audit Committee and management also formally engaged Marcum to begin to reaudit the fiscal year ending December 31, 2009.

Since July 2010, the Company has responded to a series of information requests from D&T to provide the additional information sought by D&T and has met with representatives of D&T to discuss the information and respond to additional questions from time to time.

On December 15, 2010, the Audit Committee of the Company received notice from D&T stating that D&T had concluded that D&T's report on the Company's previously issued consolidated financial statements as of and for the year ended December 31, 2009 (the "2009 financials"), including D&T's report on internal control over financial reporting at December 31, 2009, included in the Company's Annual Report on Form 10-K for the year ended December 31, 2009 (such reports, collectively, the "D&T Reports") should not be relied upon or associated with the 2009 financials.

D&T explained that its conclusion was based on the significance of the declines in operations and gross margin in the Company's February 2010 monthly financial statement, combined with the January 2010 monthly financial statements, the Company's issuance of revised projections in early May 2010 which reflected a significant decrease in the Company's 2010 projections, and D&T's disagreement with the Company's conclusion that the results shown in the February 2010 monthly financial statements would not have required a revision to the Company's projections as of the date of the 10-K filing and the issuance of D&T's reports. D&T further indicated that their decision considered their inability to perform additional audit procedures, their resignation as registered public accountants and their professional judgment that they are no longer willing to rely on management's representations due to D&T's belief that management withheld from D&T the February 2010 monthly financial statements until after the filing of the 2009 10-K and made related misrepresentations. The Audit Committee has discussed the matters disclosed herein with D&T.

The Audit Committee and the Company's management are currently evaluating these matters. The Audit Committee of the Company has commenced an investigation into the assertions that management withheld the February 2010 monthly financial statements and related misrepresentations. Management disagrees with D&T's assertions and does not believe that the February 2010 monthly financial statements were withheld. The Company does not currently believe, including after discussions with Marcum, that the reaudit will result in any changes to the 2009 financials, though no assurance can be given in this regard.

Item 9A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this Annual Report on Form 10-K, we performed an evaluation under the supervision and with the participation of management, including our Chief Executive Officer and our Chief Financial Officer, of the design and effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) under the Securities Exchange Act of 1934 as amended (the "Exchange Act"). Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded, as of the end of the period covered by this Annual Report that our disclosure controls and procedures were not effective due to material weaknesses in internal control over financial reporting as discussed in Management's Report on Internal Control Over Financial Reporting referred to below.

Notwithstanding the material weaknesses described in Management's Report on Internal Control Over Financial Reporting, our management has concluded that our consolidated financial statements for the periods covered by and included in this Annual Report are prepared in accordance with accounting principles generally accepted in the United

States (“GAAP”) and fairly present, in all material respects, our financial position, results of operations and cash flows for each of the periods presented herein.

Management’s Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as is defined in the Exchange Act. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of financial statements for external reporting purposes in accordance with GAAP. Internal control over financial reporting includes maintaining records that, in reasonable detail, accurately and fairly reflect our transactions and dispositions of the assets of the Company; providing reasonable assurance that transactions are recorded as necessary for preparation of our financial statements in accordance with GAAP; providing reasonable assurance that receipts and expenditures of the Company are made only in accordance with management

authorization; and providing reasonable assurance that unauthorized acquisition, use or disposition of Company assets that could have a material effect on our financial statements would be prevented or detected on a timely basis. Because of its 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 the degree of compliance with the policies or procedures may deteriorate.

Our management conducted an evaluation, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our internal control over financial reporting based on the framework in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this evaluation, our management concluded that our internal control over financial reporting was not effective at December 31, 2009 because of the material weaknesses described below.

Based on the COSO criteria, management identified control deficiencies that constitute material weaknesses. A "material weakness" is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is more than 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 were identified:

Material weakness related to the control environment. We concluded that, in certain instances, we did not maintain an adequate control environment that fully emphasized the establishment of, adherence to, or adequate communication regarding appropriate internal control over financial reporting. Specifically, we concluded that we did not have adequate controls in the following areas for the purposes of establishing, maintaining and communicating our control environment: (i) a sufficient number of adequately trained accounting personnel in our foreign subsidiaries with appropriate expertise in GAAP, (ii) a sufficient number of trained accounting personnel with expertise in GAAP to ensure complex material and/or non-routine transactions are properly reflected in our consolidated financial statements and (iii) a process to adequately capture and communicate relevant changes in contractual arrangements that have a financial impact. Consequently, we may not anticipate and identify accounting issues, or other risks critical to financial reporting, that could materially impact our consolidated financial statements.

Material weakness related to financial closing and reporting process. We concluded that we did not perform adequate independent review and maintain effective controls over the preparation of financial statements in the following respects: preparation of the consolidated financial statements and related notes thereto, account analyses, account summaries and account reconciliations prepared in the areas of inventory and related inventory reserves, fixed assets, deferred rent, cost of sales and certain other accounts. Specifically related to inventory, we determined that certain merchandise inventory costs were not accurately analyzed and recorded by our foreign subsidiaries resulting in a material reduction in inventory and an increase in cost of sales. We also identified deficiencies in (i) our inventory costing related to our retail segment that was offset by adjustments in our transfer pricing (ii) our identification and evaluation of manufacturing variances resulting from out-of-date standard costs and recent changes in the manufacturing process and (iii) the timely completion of our evaluation of excess and obsolete inventory reserves. These deficiencies in our internal controls over the financial closing and reporting process increase the likelihood of potential material errors to the consolidated financial statements.

Remediation of Previously Identified Material Weakness & Other Remediation Activities

While we implemented certain controls to remediate deficiencies in our internal controls over financial reporting during 2009, certain material weaknesses identified as of December 31, 2008 still remain to be remediated. Our material weaknesses as of December 31, 2009 represent continuing material weaknesses identified as of December 31, 2008. The following describes the remediation activities performed during 2009 for the partially remediated material weaknesses in the control environment and financial closing and reporting process, as well as, the completed remediation of the material weakness over the inadequate financial information systems as disclosed in the quarterly report on Form 10-Q for the quarter ended September 30, 2009.

Material weakness related to the control environment.

We filled certain key financial reporting positions at our international subsidiaries as well as our corporate headquarters which has helped to strengthen our internal and external financial reporting teams. These additional resources enhance our technical GAAP capabilities and are addressing weaknesses in financial closing and reporting

processes by improving our internal controls related to review procedures, strengthening our segregation of duties as well as enhancing our ability to account for and report on complex material and/or non-routine transactions.

Material weakness related to financial closing and reporting process.

Over the course of 2009, we continued to deploy additional modules and functionality of our integrated ERP system at

our manufacturing facilities. We also continued to enhance the existing functionality and reporting capabilities of the inventory and manufacturing modules of the same integrated ERP system. Deployment of this ERP system has already substantially improved the inventory and cost accounting systems and related internal controls. It is expected that deployment of new functionality, as well as, enhancement of existing functionality will significantly address the remaining deficiencies related to inventory closing and reporting processes.

During the fourth quarter of 2009, we deployed a sophisticated information system for financial consolidation and reporting. We expect that the deployment of this information system will substantially improve
our financial reporting process and internal controls related to reporting of inventory, fixed assets and certain other key accounts. It is expected that the controls implemented in the context of deployment of this new information system will require time to reach full operating effectiveness which is anticipated during the first half of 2010.

We have also implemented or improved internal controls related to inventory estimates for (i) shrinkage (ii) excess and obsolete inventory and (iii) fixed asset impairment. We have also implemented internal controls around the capitalization of interest expense for store build outs, implemented additional expense accruals control to account for gift card liabilities and other company expenses, and implemented additional controls around reclassification entries at the corporate level in order to help ensure proper presentation of certain financial accounts and balances.

Inadequate Financial Information Systems.

We identified systems and applications that impact financial reporting and have taken 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. We adopted an Information Technology framework, documented key information technology controls and addressed control weaknesses that could potentially impact financial reporting. In addition, we implemented a number of new policies, procedures, and controls in the areas of information security, change management, operations and end-user computing. The implementation of an integrated ERP system for our U.S. operations as of the second quarter of 2009 increased timeliness and accuracy of our financial information. We have reviewed our personnel and information systems for foreign operations and have added professional staff resources for review and control over financial reporting by our foreign operations.

We have placed substantial mitigating controls around our manual consolidation process, and we are 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, we have identified and implemented additional review controls over financial reporting to validate information derived from its information systems and ultimately reported in our financial statements.

Changes in Internal Controls over Financial Reporting

There has been no change in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) during the most recent fiscal quarter ended December 31, 2009 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting, except for the implementation and deployment of a sophisticated information system for financial consolidation and reporting as discussed above in Remediation of Previously Identified Material Weakness & Other Remediation Activities.

Management’s Plan to Remediate Material Weaknesses

We have developed plans for 2010 to continue to remediate the outstanding material weaknesses described above in Management’s Report on Internal Control Over Financial Reporting. We are committed to remediating these material weaknesses and estimate that the material weaknesses will be remediated by the end of 2010. We do not anticipate incurring substantial costs in connection with the remediation efforts, with the exception of hiring additional technically qualified resources in our domestic and international finance departments. The following describes our remediation plans for 2010:

Material weakness related to the control environment: We have identified a number of additional resources necessary to improve the overall domestic and international financial accounting and reporting departments. We are in process of recruiting resources for some of these key financial positions that are expected to enhance the overall technical capabilities of our resources. Additionally, we are evaluating appropriate training for existing personnel in the areas of GAAP and the development of corporate wide procedures to facilitate uniform application of accounting policies on a global basis. We will take necessary steps to improve the process of evaluating, identifying and communicating

changes in contractual arrangements to ensure the potential financial statement impact of such changes is considered on a timely basis.

Material weakness related to financial closing and reporting process: During 2010, we will continue to improve the preparation and review of account reconciliations by developing specific procedures to monitor and evaluate the key accounts.

Additionally, we will provide additional training to our personnel to strengthen their GAAP knowledge and ability to identify potential errors in the underlying business processes. To address inventory costing, we are in the process of (i) transitioning responsibility for maintaining and establishing standard costs from our production planning department to our accounting department (ii) enhancing production reporting capabilities in order to separately record and analyze key production variances (iii) developing automated capabilities to capture direct labor to specific production runs and (iv) enhancing our international cost accounting procedures for intercompany inventory transfers and costing.

PART IV

Item 15. Exhibits, Financial Statement Schedules

(a) Documents filed as part of this Annual Report on Form 10-K/A:

1 Financial Statements: See “Index to Consolidated Financial Statements” in Part II, Item 8 of this Form 10-K/A.

2 Financial Statement Schedule: The following consolidated financial statement schedule of American Apparel, Inc. and its subsidiaries is included in Part II, Item 8:

Schedule II—Valuation and Qualifying Accounts

Schedules other than those listed above are omitted because of an absence of the conditions under which they are required or because the required information is shown in the consolidated financial statements and/or notes thereto.

(b) Exhibits: The exhibits listed in the accompanying index to exhibits are filed or incorporated by reference as part of this Annual Report on Form 10-K/A.

In reviewing the agreements included as exhibits to this Annual Report on Form 10-K/A, 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 our 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 our may be found elsewhere in this Annual Report on Form 10-K/A and in our other public filings, which are available without charge through the SEC’s website at http://www.sec.gov.

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. 00l-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. 00l-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)

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. (success 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. 00l-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. 00l-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. 00l-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)
10.1	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 Mary 16, 2008 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)

Exhibit No.	Description
10.15	Seventh Amendment to Credit Agreement, dated as of December 30, 2009, amending the BofA Credit Agreement (included as Exhibit 10.2 of the Current Report on Form 8-K (File No. 001-32697) filed January 6, 2010 and incorporated by reference herein
10.16	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. 00l-32697) filed December 18, 2007 and incorporated by reference herein)
10.17	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. 00l-32697) filed December 18, 2007 and incorporated by reference herein)
10.18	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. 00l-32697) filed December 18, 2007 and incorporated by reference herein)
10.19	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. 00l-32697) filed December 18, 2007 and incorporated by reference herein)
10.2	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)
10.21	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)
10.22	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, 2008 and incorporated by reference herein)
10.23	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)
10.24	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)
10.25	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)
10.26	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. 00l-32697) filed December 18, 2007 and incorporated by reference herein)

Exhibit No.	Description
10.27	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. 00l-32697) filed December 18, 2007 and incorporated by reference herein)
10.28	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. 00l-32697) filed December 18, 2007 and incorporated by reference herein)
10.29	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. 00l-32697) filed December 18, 2007 and incorporated by reference herein)
10.3	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. 00l-32697) filed December 18, 2007 and incorporated by reference herein)
10.31	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)
10.32	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. 00l-32697) filed December 18, 2007 and incorporated by reference herein)
10.33	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. 00l-32697) filed December 18, 2007 and incorporated by reference herein)
10.34+	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)
10.35+	First Amendment to Employment Agreement, dated as of March 11, 2009, among the Registrant, AAUSA and Joyce E. Crucillo
10.36	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)
10.37	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)

10.38+	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)
10.39+	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)

Exhibit No.	Description
10.4	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)
10.41+	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)
10.42	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)
10.43	Credit Agreement, dated as of March 13, 2009, among our, certain subsidiaries of our, 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)
10.44	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 (Guernesey) 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)
10.45	Amendment and Agreement, dated as of April 10, 2009, by and between the Registrant and Lion/Hollywood L.L.C. (included as Exhibit 10.1 of Current Report on Form 8-K (File No 001-32697) filed April 16, 2009 and incorporated by reference herein)
10.46	Agreement to Terminate Voting Agreement, entered into as of April 14, 2009, by and among the Registrant, Jonathan J. Ledecky, Cullen Equities UK Limited, Jay H. Nussbaum, Kerry Kennedy, Robert B. Hersov, Edward J. Mathias, Richard Y. Roberts and Dov Charney (included as Exhibit 10.2 of Current Report on Form 8-K (File No 001-32697) filed April 16, 2009 and incorporated by reference herein)
10.47	Second Amendment and Agreement, dated as of June 17, 2009, by and between the Registrant and Lion/Hollywood L.L.C. (included as Exhibit 10.1 of Current Report on Form 8-K (File No 001-32697) filed June 19, 2009 and incorporated by reference herein)
10.48	Third Amendment and Agreement, dated as of August 18, 2009, by and between the Registrant and Lion/Hollywood L.L.C. (included as Exhibit 10.1 of Current Report on Form 8-K (File No 001-32697) filed August 20, 2009 and incorporated by reference herein)
10.49	Waiver to Credit Agreement, dated as of September 30, 2009, among the Registrant, the facility guarantors from time to time party thereto, Wilmington Trust FSB, as the administrative agent and the collateral agent, Lion Capital (Americas) Inc., as a lender, Lion/Hollywood L.L.C., as a lender, and other lenders from time to time party thereto (included as Exhibit 10.1 of Current Report on Form 8-K (File No. 001-32697) filed October 6, 2009 and incorporated by reference herein)

10.5	Letter Agreement Re: Pledging of Restricted Securities, dated October 28, 2009, among Dov Charney, Lion/Hollywood L.L.C. and the Registrant (included as Exhibit 10.1 of Current Report on Form 8-K (File No. 001-32697) filed November 3, 2009 and incorporated by reference herein)
10.51+	American Apparel, Inc. Incentive Compensation Plan (included as Appendix A of the Revised Definitive Proxy Statement (No. 001-32697), filed September 11, 2009 and incorporated by reference herein)

Exhibit No.	Description
10.52	Credit Agreement, dated as of December 30, 2009, between American Apparel Canada Wholesale Inc. and American Apparel Canada Retail Inc. and Bank of Montreal (included as Exhibit 10.1 of Current Report on Form 8-K (File No. 001-32697) filed January 6, 2010 and incorporated by reference herein)
10.53	First Amendment to Credit Agreement, dated as of December 30, 2009, among American Apparel, Inc., the facility guarantors from time to time party thereto, Wilmington Trust FSB, as the administrative agent and collateral agent, Lion Capital (Americas) Inc., as a lender, Lion/Hollywood L.L.C., as a lender, and other lenders from time to time party thereto (included as Exhibit 10.3 of Current Report on Form 8-K (File No. 001-32697) filed January 6, 2010 and incorporated by reference herein)
10.54	Second Amendment to Credit Agreement, dated as of March 31, 2010, among American Apparel, Inc., the facility guarantors from time to time party thereto, Wilmington Trust FSB, as the administrative agent and collateral agent, Lion Capital (Americas) Inc., as a lender, Lion/Hollywood L.L.C., as a lender, and other lenders from time to time party thereto
10.55	Lease, dated as of July 30, 2009, by and between Alameda Produce Market, LLC and AAI
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)
16.1	Letter of Marcum & Kliegman LLP, dated April 10, 2009 (included as Exhibit 16.1 of the Amendment No. 1 to Current Report on 8-K/A (File No. 001-32697) filed April 10, 2009 and incorporated by reference herein)
21.1	List of Subsidiaries
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.

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.

February 6, 2011	By: /s/ DOV CHARNEY Dov Charney

Chief Executive Officer
(Principal Executive Officer)