AMERICAN APPAREL, INC
Form 10-Q
November 08, 2011
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2011
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File No. 001-32697

American Apparel, Inc.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	20-3200601
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
747 Warehouse Street, Los Angeles, California	90021
(Address of Principal Executive Offices)	(Zip Code)

Registrant's Telephone Number, Including area code: (213) 488-0226

Indicate by checkmark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of “large accelerated filer” and “accelerated filer,” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer	o	Accelerated filer	x
Non-accelerated filer	o (Do not check if a smaller reporting company)	Smaller reporting company	o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.
Common stock, $0.0001 par value 109,071,961 shares issued (4,483,627 subject to vesting) on November 7, 2011.

Table of Contents

AMERICAN APPAREL, INC.
TABLE OF CONTENTS

Table of Contents

Unless the context requires otherwise, all references in this report to the “Company,” “Registrant”, “we,” “our,” and “us” refer American Apparel, Inc., a Delaware corporation, together with its wholly owned subsidiary, American Apparel (USA), LLC, and its other direct and indirect subsidiaries.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q, including the documents incorporated by reference herein, contains forward-looking statements within the “safe harbor” provisions of the Private Securities Litigation Reform Act of 1995. All statements in this Quarterly Report on Form 10-Q other than statements of historical fact are “forward-looking statements” for purposes of these provisions. Statements that include the use of terminology such as “may,” “will,” “expects,” “believes,” “plans,” “estimates,” “potential,” or “continue,” or the negative thereof or other and similar expressions are forward-looking statements. In addition, in some cases, you can identify forward-looking statements by words or phrases such as “trend,” “potential,” “opportunity,” “believe,” “comfortable,” “expect,” “anticipate,” “current,” “intention,” “es “position,” “assume,” “outlook,” “continue,” “remain,” “maintain,” “sustain,” “seek,” “achieve,” and similar expressions. Any statements that refer to projections of our future financial performance, our anticipated growth and trends in our business, our goals, strategies, focuses and plans and other characterizations of future events or circumstances, including statements expressing general expectations or beliefs, whether positive or negative about future operating results or the development of our products and any statement of assumptions underlying any of the foregoing are forward-looking statements. Forward-looking statements in this report may include, without limitation, statements about:

- future financial condition and operating results;
- our ability to remain in compliance with financial covenants under our financing arrangements;
- our ability to extend, renew or refinance our existing debt;
- our liquidity and losses from operations and projected cash flows and related impact on our ability to continue as a going concern;
- our plan to make continued investments in advertising and marketing;
- our growth, expansion and acquisition prospects and strategies, the success of such strategies, and the benefits we believe can be derived from such strategies;
- the outcome of investigations, enforcement actions and litigation matters, including exposure which could exceed expectations;
- our intellectual property rights and those of others, including actual or potential competitors; our personnel, consultants, and collaborators;
- operations outside the United States;
- trends in raw material costs and other costs both in the industry and specific to the Company;
- the supply of raw materials and the effects of supply shortages on our financial condition and results of operations;
- economic and political conditions;
- overall industry and market performance;
- the impact of accounting pronouncements;
- our ability to improve manufacturing efficiency at our production facilities;
- management's goals and plans for future operations; and
- other assumptions described in this Quarterly Report on Form 10-Q underlying or relating to any forward-looking statements.

The forward-looking statements in this report speak only as of the date of this report and caution should be taken not to place undue reliance on any such forward-looking statements, which are qualified in their entirety by this cautionary statement. Forward-looking statements are subject to numerous assumptions, events, risks, uncertainties and other factors, including those that may be outside of our control and that change over time. As a result, actual results and/or the timing of events could differ materially from those expressed in or implied by the forward-looking statements and future results could differ materially from historical performance. Such assumptions, events, risks, uncertainties and other factors include, among others, those described

3

Table of Contents

under Part II, Item IA and elsewhere in this report and in the Company's Annual Report on Form 10-K for the year ended December 31, 2010 (filed with the United States Securities and Exchange Commission (the "SEC") on March 31, 2011) as well as in other reports and documents we file with the SEC and include, without limitation, the following:

- our ability to generate or obtain from external sources sufficient liquidity for operations and debt service;
- changes in the level of consumer spending or preferences or demand for our products;
- our liquidity and losses from operations and projected cash flows and related impact on our ability to continue as a going concern;
- disruptions in the global financial markets;
- consequences of our significant indebtedness, including our ability to comply with our debt agreements and generate cash flow to service our debt;
- our ability to regain compliance with the exchange rules of the NYSE Amex, LLC;
- the highly competitive and evolving nature of our business in the U.S. and internationally;
- our ability to effectively carry out and manage our strategy, including growth and expansion both in the U.S. and internationally;
- loss of U.S. import protections or changes in duties, tariffs and quotas and other risks associated with international business;
- intensity of competition, both domestic and foreign;
- technological changes in manufacturing, wholesaling, or retailing;
- risks that our suppliers may not timely produce or deliver our products;
- loss or reduction in sales to our wholesale or retail customers or financial nonperformance by our wholesale customers;
- the adoption of new accounting pronouncements or changes in interpretations of accounting principles;
- our ability to pass on the added cost of raw materials to our wholesale and retail customers;
- the availability of store locations at appropriate terms and our ability to identify and negotiate new store locations effectively and to open new stores and expand internationally;
- our ability to attract customers to our stores;
- seasonality and fluctuations in comparable store sales and margins;
- our ability to successfully implement our strategic, operating, financial and personnel initiatives;
- our ability to maintain the value and image of our brand and protect our intellectual property rights;
- changes in the cost of materials and labor, including increases in the price of raw materials in the global market;
- our ability to improve manufacturing efficiency at our production facilities;
- location of our facilities in the same geographic area;
- our relationships with our lenders and our ability to comply with the terms of our existing debt facilities;
- risks associated with our foreign operations and foreign supply sources, such as disruption of markets, changes in import and export laws, currency restrictions and currency exchange rate fluctuations;
- adverse changes in our credit ratings and any related impact on financial costs and structure;
- continued compliance with U.S. and foreign government regulations, legislation and regulatory environments, including environmental, immigration, labor and occupational health and safety laws and regulations;
- the risk that information technology systems changes may disrupt our supply chain or operations and our ability to upgrade our information technology infrastructure and other risks associated with the systems that operate our online retail operations;
- litigation and other inquiries and investigations, including the risks that we or our officers will not be successful in defending any proceedings, lawsuits, disputes, claims or audits, and that exposure could exceed expectations or insurance coverages;
- our ability to effectively manage inventory and inventory reserves;

Table of Contents

- changes in key personnel, our ability to hire and retain key personnel, and our relationship with our employees;
- material weaknesses in internal controls;
- costs as a result of operating as a public company;
- general economic conditions, including increases in interest rates, geopolitical events, other regulatory changes and inflation or deflation;
- our ability to find a new qualified independent director to fill the vacancy on our Audit Committee and our ability to realign our Board of Directors, in each case within the timeframe prescribed by the NYSE Amex Company Guide, in order to regain compliance with NYSE Amex listing standards and maintain listing on the NYSE Amex;
- disruptions due to severe weather or climate change; and
- any other risks that we may identify in this Form 10-Q or in the documents that we incorporate by reference.

All forward-looking statements speak only as of the date of this Form-10Q or, in the case of any documents incorporated by reference in this Form-10Q, the date of such document, in each case based on information available to us as of such date, and we assume no obligation to update any forward-looking statements, except as required by law.

PART I-FINANCIAL INFORMATION

Item 1. Financial Statements

American Apparel, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

(Amounts in thousands)

	September 30, 2011 (unaudited)	December 31, 2010*
ASSETS		
CURRENT ASSETS		
Cash	$7,968	$7,656
Trade accounts receivable, net of allowances of $2,037 and $2,630 at September 30, 2011 and December 31, 2010, respectively	18,569	16,688
Prepaid expenses and other current assets	9,304	9,401
Income taxes receivable and prepaid income taxes	5,435	4,114
Inventories, net	185,598	178,052
Deferred income taxes, net of valuation allowance of $9,682 and $9,661 at September 30, 2011 and December 31, 2010, respectively	448	626
Total current assets	227,322	216,537
PROPERTY AND EQUIPMENT, net	71,331	85,400
DEFERRED INCOME TAXES, net of valuation allowance of $42,665 and $42,318 at September 30, 2011 and December 31, 2010, respectively	1,091	1,695
OTHER ASSETS, net	23,896	24,318
TOTAL ASSETS	$323,640	$327,950
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Cash overdraft	$844	$3,328
Revolving credit facilities and current portion of long-term debt, net of unamortized discount of $16,012 at December 31, 2010	55,784	138,478
Accounts payable	31,558	31,534
Accrued expenses and other current liabilities	39,420	39,028
Fair value of warrants and purchase rights	11,899	993
Income taxes payable	173	230
Current portion of capital lease obligations	1,207	560
Total current liabilities	140,885	214,151
LONG-TERM DEBT, net of unamortized discount of $22,414 at September 30, 2011	89,850	444
SUBORDINATED NOTES PAYABLE TO RELATED PARTY	—	4,611
CAPITAL LEASE OBLIGATIONS, net of current portion	1,998	542
DEFERRED TAX LIABILITY	167	260
DEFERRED RENT	23,064	24,924
OTHER LONG-TERM LIABILITIES	11,547	7,994
TOTAL LIABILITIES	267,511	252,926
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY		
Preferred stock, $0.0001 par value per share, authorized 1,000 shares; none issued	—	—
	10	8

Common stock, $0.0001 par value per share, authorized 230,000 shares (120,000 shares at December 31, 2010); 108,487 shares issued and 103,274 shares outstanding at September 30, 2011 and 79,192 shares issued and 73,838 shares outstanding at December 31, 2010		
Additional paid-in capital	163,001	153,881
Accumulated other comprehensive loss	(3,033)	(3,168)
Accumulated deficit	(101,692)	(73,540)
Less: Treasury stock, 304 shares at cost	(2,157)	(2,157)
TOTAL STOCKHOLDERS' EQUITY	56,129	75,024
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$323,640	$327,950

* Condensed from audited financial statements

See accompanying notes to condensed consolidated financial statements.

6

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Net sales	$140,889	$134,473	$389,760	$389,020
Cost of sales	65,898	64,288	178,705	189,210
Gross profit	74,991	70,185	211,055	199,810
Selling expenses	52,283	55,177	152,536	159,134
General and administrative expenses (including related party expenses of $197 and $224 for the three months, and $628 and $661 for the nine months ended 2011 and 2010, respectively)	24,552	22,481	77,025	72,670
Retail store impairment	784	576	2,436	6,173
Loss from operations	(2,628)	(8,049)	(20,942)	(38,167)
Interest expense (including related party interest expense of $ - and $67 for the three months, and $64 and $199 for the nine months ended 2011 and 2010, respectively)	8,832	6,363	23,715	17,091
Foreign currency transaction loss (gain)	1,855	(3,304)	780	(620)
Unrealized (gain) loss on change in fair value of warrants and purchase rights	(6,101)	(410)	(21,201)	624
Loss on extinguishment of debt	—	—	3,114	—
Other income	(186)	(35)	(240)	(236)
Loss before income taxes	(7,028)	(10,663)	(27,110)	(55,026)
Income tax provision (benefit)	166	(1,172)	1,042	11,986
Net loss	$(7,194)	$(9,491)	$(28,152)	$(67,012)
Basic and diluted loss per share	$(0.07)	$(0.13)	$(0.32)	$(0.94)
Weighted average basic and diluted shares outstanding	102,279	71,447	88,614	71,388

See accompanying notes to condensed consolidated financial statements.

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

	Nine Months Ended September 30,			
	2011		2010	
CASH FLOWS USED IN OPERATING ACTIVITIES				
Cash received from customers	$387,780		$386,478	
Cash paid to suppliers, employees and others	(392,684	)	(410,168	)
Income taxes (paid) refunded	(1,413	)	1,320	
Interest paid	(3,959	)	(5,383	)
Other	323		247	
Net cash used in operating activities	(9,953	)	(27,506	)
CASH FLOWS USED IN INVESTING ACTIVITIES				
Capital expenditures	(7,284	)	(11,316	)
Proceeds from sale of fixed assets	72		43	
Net cash used in investing activities	(7,212	)	(11,273	)
CASH FLOWS PROVIDED BY FINANCING ACTIVITIES				
Cash overdraft	(2,484	)	(2,265	)
(Repayments) borrowings under revolving credit facilities, net	(1,309	)	43,496	
Net proceeds from issuance of common stock and exercise of purchase rights	21,710		—	
Payment of debt issuance costs	(1,690	)	(592	)
Repayment of term loans and notes payable	(10	)	(88	)
Proceeds from capital lease obligations	3,100		—	
Repayment of capital lease obligations	(996	)	(1,488	)
Net cash provided by financing activities	18,321		39,063	
EFFECT OF FOREIGN EXCHANGE RATE ON CASH	(844	)	(879	)
NET INCREASE (DECREASE) IN CASH	312		(595	)
CASH, beginning of period	7,656		9,046	
CASH, end of period	$7,968		$8,451	
RECONCILIATION OF NET LOSS TO NET CASH USED IN OPERATING ACTIVITIES				
Net loss	$(28,152	)	$(67,012	)
Depreciation and amortization of property and equipment and intangibles	19,109		21,118	
Amortization of debt discount and deferred financing costs	6,120		4,457	
Foreign exchange transaction loss (gain)	780		(620	)
Stock based compensation expense	4,538		1,763	
Accrued interest paid-in-kind	13,636		7,251	
Allowance for inventory shrinkage and obsolescence	783		1,032	
Change in fair value of warrants and purchase rights	(21,201	)	624	
Loss on extinguishment of debt	3,114		—	
Retail store impairment	2,436		6,173	
Deferred income taxes	793		17,162	
Gain on disposal of property and equipment	83		12	
Bad debt expense	503		676	
Deferred rent	(1,862	)	2,436	
Changes in cash due to changes in operating assets and liabilities:				
Trade accounts receivables	(2,483	)	(3,218	)
Inventories	(8,651	)	(26,061	)
Prepaid expenses and other current assets	(174	)	2,198	
Other assets	(2,880	)	(2,009	)

Accounts payable	1,492	11,486
Accrued expenses and other liabilities	3,227	(3,650)
Income taxes receivable/payable	(1,164)	(1,324)
Net cash used in operating activities	$(9,953)	$(27,506)
NON-CASH INVESTING AND FINANCING ACTIVITIES		
Conversion of debt to equity	$4,688	$—
Property and equipment acquired and included in accounts payable	$1,488	$1,517
Reclassification of Lion Warrant from equity to debt	$11,339	$—
Issuance of warrants and purchase rights at fair value	$6,387	$1,762
Exercise of purchase rights	$2,857	$—

See accompanying notes to condensed consolidated financial statements.

American Apparel, Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements
For the Three and Nine Months Ended September 30, 2011 and 2010
(Amounts and shares in thousands, except per share amounts)
(unaudited)

Note 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 September 30, 2011, the Company operated a total of 247 retail stores in the United States, Canada and 18 other countries.

Going Concern, Liquidity and Management's Plan
As of September 30, 2011, the Company had $7,968 in cash, $3,929 of availability for additional borrowings and $51,079 outstanding on the $75,000 revolving credit facility under the BofA Credit Agreement which matures in July 2012 (see Note 7), $2,789 of availability for additional borrowings and $4,650 outstanding on a C$11,000 revolving credit facility under the Bank of Montreal Credit Agreement (see Note 7), and $89,454 (including paid-in-kind interest of $12,474 and net of discount $22,414) of term loans outstanding under the Lion Credit Agreement (see Note 8). As of October 31, 2011, the Company had $7,496 of availability for additional borrowings and $47,595 outstanding on the credit facility under the BofA Credit Agreement and $3,493 of availability for additional borrowings and $4,121 outstanding on the credit facility under the Bank of Montreal Credit Agreement.

During the nine months ended September 30, 2011, and as more fully described in Notes 10 and 13, the Company sold 26,763 shares of its common stock and received aggregate cash proceeds, net of transaction costs, of $21,710, which provided aggregate liquidity to the Company of $16,710 as a result of the following transactions: (i) On March 24, 2011, the Company sold 1,801 shares of common stock at a price of $1.11 per share, to Dov Charney ("Mr. Charney"), Chairman and CEO of the Company, for aggregate proceeds, net of transaction costs, of $2,000; (ii) On April 26, 2011 the Company sold 15,777 shares of common stock to a group of investors (the "Investors"), at a price of $0.90 per share, and purchase rights to acquire up to an aggregate of 27,443 additional shares of common stock at $0.90 per share, for the aggregate proceeds, net of transaction costs, of $12,416; (iii) On April 26, 2011 the Company had a mandatory increase in its lender reserve of $5,000 under the BofA Credit Agreement; (iv) On July 7, 2011, the Investors exercised their purchase rights to purchase an additional 6,667 shares of the Company's common stock for $0.90 per share, and (v) On July 12, 2011, Mr. Charney purchased 778 shares of common stock for $0.90 per share, and the Investors exercised additional rights to purchase 1,740 shares of common Stock for $0.90 per share. These transactions resulted in aggregate proceeds, net of transaction costs, of $7,294.

The Company incurred a loss from operations of $20,942 for the nine months ended September 30, 2011, compared to a loss from operations of $38,167 for the nine months ended September 30, 2010. The current operating plan indicates that losses from operations will be incurred for all of fiscal 2011. Consequently, the Company may not have sufficient liquidity necessary to sustain operations for the next twelve months and this raises substantial doubt that the Company will be able to continue as a going concern.

Management is in the process of executing a plan to improve the operating performance and the financial position of the Company. This plan includes optimizing production levels at the Company's manufacturing facilities including raw material purchases and labor; streamlining the Company's logistics operations; reducing corporate expenses; merchandise price rationalization in the Company's wholesale and retail channels; renegotiating the terms of a number of the Company's retail real estate leases, including store closures; improving merchandise allocation procedures and rationalizing staffing levels. In addition, the Company continues to develop other initiatives intended to either increase sales, reduce costs or improve liquidity. Although management's plan reflects improvements in these trends, there can be no assurance that management's plan to improve the operating performance and the financial position of the Company will be successful. The Company continues to evaluate other alternative sources of capital for ongoing cash needs, however, there can be no assurance the Company will be successful in those efforts.

On April 26, 2011, the Company entered into an amendment under the BofA Credit Agreement, which among other things, waived the requirement to furnish the Company's 2010 audited financial statements without a “going concern” or like qualification. On the same date, the Company also entered into an amendment under the Lion Credit Agreement, which waived the requirement to furnish the 2010 audited financial statements without a "going concern" or like qualification. On May 9, 2011, the Company entered into a waiver agreement with the Bank of Montreal, which waived the requirement to furnish the fiscal 2010 audited financial statements of the Company's Canadian operations without a "going concern" or like qualification. There can be no assurance in the future that the Company will be able to receive a waiver, if necessary, with respect to its fiscal 2011 audited financial statements.

The accompanying condensed consolidated financial statements do not include any adjustments to reflect the possible future effects on the recoverability of assets or the amounts of liabilities that may result should the Company be unable to continue as a going concern.

Note 2. Principles of Consolidation and Basis of Presentation
The unaudited condensed 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.

The accompanying unaudited condensed consolidated financial statements of the Company and its wholly owned subsidiaries have been prepared by the Company, in accordance with accounting principles generally accepted in the United States (“GAAP”) for interim financial information and are presented in accordance with the requirements of Form 10-Q and Rule 10-01 of Regulation S-X, and have not been audited. Accordingly, these unaudited condensed consolidated financial statements do not include all of the information and notes required by GAAP for complete financial statements and should be read in conjunction with the consolidated financial statements and notes thereto for the fiscal year ended December 31, 2010 included in the Company's Annual Report on Form 10-K. In the opinion of management, the interim unaudited condensed consolidated financial statements included herein contain all adjustments, including normal recurring adjustments, considered necessary to present fairly the Company's financial position, the results of operations and cash flows for the periods presented.

The operating results and cash flows of the interim periods presented herein are not necessarily indicative of the results to be expected for any other interim period or the full year.

Certain reclassifications have been made to the accompanying 2010 condensed consolidated financial statements to conform them to the 2011 presentation.

Note 3. Summary of Significant Accounting Policies and Other Disclosures
Use of Estimates
The preparation of financial statements in conformity with GAAP 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 other allowances; allowance for doubtful accounts; inventory valuation and obsolescence; valuation and recoverability of long-lived assets, including the values assigned to acquired intangible assets and goodwill, and property and equipment; contingencies, including accruals for the outcome of current litigation and self-insurance liabilities; fair value of debt; fair value of derivatives; and income taxes, including uncertain tax positions and recoverability of deferred income taxes.
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.

Earnings Per Share

The Company presents earnings per share ("EPS") utilizing a dual presentation of basic and diluted EPS. Basic EPS includes no dilution and is computed by dividing net loss available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted EPS includes the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock.

Comprehensive Loss

The Company is required to display comprehensive loss and its components as part of its complete set of financial statements. Comprehensive loss 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 loss, specifically, unrealized gains and losses on foreign currency translation adjustments.

A reconciliation of comprehensive loss for the three and nine months ended September 30, 2011 and 2010 is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Net loss, as reported	$(7,194)	$(9,491)	$(28,152)	$(67,012)
Foreign currency translation adjustments	(1,279)	1,093	135	(121)
Comprehensive loss	$(8,473)	$(8,398)	$(28,017)	$(67,133)

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 cash risk by investing through major financial institutions. The Company had approximately $7,473 and $7,038 held in foreign banks at September 30, 2011, and December 31, 2010, respectively.

The Company mitigates its risks related to trade receivables by performing 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 current credit information. The Company also maintains an insurance policy for certain customers based on the customer's credit rating and established limits. Collections and payments from customers are continuously monitored. One customer accounted for 22.5% and 24.3% of the Company's total trade accounts receivable as of September 30, 2011 and December 31, 2010, respectively. The Company maintains an allowance for doubtful accounts, which is based upon historical experience and specific customer collection issues that are 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.

Foreign Currency Forward Exchange Contracts

Derivative instruments are required to be recognized in the balance sheet as either an asset or liability measured at fair value. Changes in the fair value of derivatives are to be recorded each period in comprehensive loss, if the derivative is designated and effective as part of a hedge accounting transaction, 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 the condensed consolidated statements of operations.

The Company enters into forward contracts from time-to-time to mitigate the cash and statement of operations impact of fluctuations in foreign currencies. At September 30, 2011, the Company held no forward exchange contracts. For the nine months ended September 30, 2011, losses of $33, and for the three and nine months ended September 30, 2010, a gain of $2 and a loss of $8, respectively, were recorded in the accompanying condensed consolidated statements of operations.

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 it is more likely than not that those assets will not be realized. If it becomes more likely than not that a tax asset will be realized, the related valuation allowance on such assets will 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 liabilities. In management's opinion, adequate provisions for income taxes have been made for all years. If actual taxable income 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 foreign taxes paid.

The Company accounts for uncertain tax positions in accordance with Accounting Standards Codification ("ASC") ASC 740—“Income Taxes”, and gross unrecognized tax benefits at September 30, 2011 and December 31, 2010 are included in other long-term liabilities in the accompanying condensed 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 condensed 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 note, warrants and purchase rights. The fair value of cash, 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 9). The fair value of each warrant and each purchase right is estimated using the Binomial Lattice and Monte Carlo simulation valuation models (see Note 13).

The valuation techniques utilized 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.

The Company utilizes observable market inputs (quoted market prices) when measuring 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. No triggering events occurred during the three and nine months ended September 30, 2011 and therefore an impairment test of goodwill was not performed.

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), impairment adjustments were required, and are included in the accompanying condensed consolidated statement of operations (see Note 5).

Note 4. Inventories

The components of inventories are as follows:

	September 30, 2011	December 31, 2010
Raw materials	$18,639	$18,461
Work in process	1,525	1,125
Finished goods	171,935	164,319
	192,099	183,905
Less reserve for inventory shrinkage and obsolescence	(6,501)	(5,853)
Total, net of reserves	$185,598	$178,052

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 three and nine months ended September 30, 2011 and 2010, no 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 and provides reserves for such identified excess and slow-moving inventories. At September 30, 2011 and December 31, 2010, the Company had a lower of cost or market reserve for excess and slow-moving inventories of $3,362 and $3,869, respectively.

The Company establishes a reserve for inventory shrinkage for each of its retail locations and its warehouse. The reserve is based on the historical results of physical inventory counts. The Company has a reserve for inventory shrinkage in the amount of $3,139 and $1,984 at September 30, 2011 and December 31, 2010, respectively.

Note 5. Property and Equipment

The components of property and equipment are as follows:

	September 30, 2011	December 31, 2010
Machinery and equipment	$47,748	$46,755
Furniture and fixtures	39,338	38,515
Computers and software	29,631	28,133
Automobiles and light trucks	1,076	1,173
Leasehold improvements	81,245	86,572
Buildings	566	585
Construction in progress	330	584
	199,934	202,317
Less accumulated depreciation and amortization	(128,603)	(116,917)
Total	$71,331	$85,400

Property and equipment is recorded on the basis of cost and depreciated over the estimated used useful lives of fixed assets. The useful lives of the Company's major classes of assets are as follows:

Machinery and equipment	5 to 7 years
Furniture and fixtures	3 to 5 years
Computers and software	3 to 5 years
Automobiles and light trucks	3 to 5 years
Leasehold improvements	Shorter of lease term or useful life
Buildings	25 years

Depreciation and amortization expense relating to property and equipment (including capitalized leases) is recorded in cost of sales and operating expenses. Depreciation and amortization was $6,126 and $19,109 for the three and nine months ended September 30, 2011, respectively, and $6,704 and $21,118 for the three and nine months ended September 30, 2010, respectively.

The Company identified indicators of impairment at certain retail stores within its U.S. Retail, Canadian, and International

segments, specifically related to under-performance or operating losses relative to expected historical or projected future operating results. The Company performed a recoverability test and an impairment test on these stores. The key assumptions used in the estimates of projected cash flows were sales, gross margins, and payroll costs. These forecasts were based on historical trends and take into account recent developments as well as the Company's plans and intentions. Based upon the results of the discounted cash flow analysis (level 3 in the fair value hierarchy), the Company recorded an impairment charge relating primarily to certain retail store leasehold improvements and key money in the U.S. Retail, Canadian, and International segments of $784 and $2,436 for the three and nine months ended September 30, 2011, respectively, and $576 and $6,173 for the three and nine months ended September 30, 2010, respectively.
On January 11, 2011, the Company entered an agreement to sell and simultaneously lease back all of the Company's unencumbered manufacturing equipment, for a term of 48 months and an interest rate of 14.8%. The sale price of the manufacturing equipment was $3,100. The Company has an option, exercisable during the fourth year of the lease term, to repurchase the manufacturing equipment for $310. The transaction is accounted for as a financing transaction and is recorded in the accompanying condensed consolidated financial statements as a capital lease.

Note 6. Accrued Expenses and Other Current Liabilities
The components of accrued expenses and other current liabilities are as follows:

	September 30, 2011	December 31, 2010
Compensation and related taxes	$8,388	$7,586
Workers' compensation and other self-insurance reserves (Note 16)	5,244	4,261
Sales, value and property taxes	2,499	2,570
Gift cards and store credits	5,387	4,927
ICE inspection-related workers' compensation claims (Notes 15 and 16)	781	1,443
Loss contingencies	2,275	2,200
Accrued vacation	780	1,937
Other	14,066	14,104
Total accrued expenses	$39,420	$39,028

Note 7. Revolving Credit Facilities and Current Portion of Long-Term Debt
Revolving credit facilities and current portion of long-term debt consists of the following:

	September 30, 2011	December 31, 2010
Revolving credit facility, maturing July 2012	$51,079	$53,414
Revolving credit facility (Canada), maturing December 2012	4,650	3,799
Current portion of long-term debt (Note 8)	55	81,265
Total revolving credit facilities and current portion of long-term debt	$55,784	$138,478

Revolving Credit Facility
The Company has a revolving credit facility of $75,000 with Bank of America, N.A. (“BofA” and such credit facility, the “BofA Credit Agreement”), subject to certain advance restrictions based on eligible inventory and accounts receivable. The BofA Credit Agreement expires on 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 U.S. assets and shares in its foreign subsidiaries. Available borrowing capacity at September 30, 2011 and December 31, 2010 was $3,929 and $4,915, respectively.

Interest under the BofA Credit Agreement is at the 3-month London Interbank Offered Rate (“LIBOR”) (0.37% at September 30, 2011) 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 September 30, 2011) plus 2.5%, at the Company's option. At September 30, 2011 and

December 31, 2010, the Company had $7,492 and $8,583, respectively, of outstanding letters of credit secured against the BofA Credit Agreement.

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. Additionally, the BofA Credit Agreement contains cross-default provisions with the Lion Credit Agreement and the Bank of Montreal Credit Agreement, whereby an event of default occurring under the Lion Credit Agreement or the Bank of Montreal Credit Agreement would cause an event of default under the BofA Credit Agreement.

On April 26, 2011, the Company entered into an amendment under the BofA Credit Agreement, which among other things,