AMERICAN APPAREL, INC
Form 10-Q
May 11, 2015
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 quarter ended March 31, 2015
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

At May 6, 2015, the Registrant had issued and outstanding 176,682,164 and 176,376,508 shares of its common stock, respectively.

Table of Contents

AMERICAN APPAREL, INC.
TABLE OF CONTENTS

Table of Contents

Unless the context requires otherwise, all references in this Quarterly Report on Form 10-Q to the "Company," "Registrant," "we," and "our," refer to American Apparel, Inc., a Delaware corporation, together with its 100% 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," "expect," "believe," "plan," "estimate," "potential," "continue," or the negative thereof or other and similar expressions are forward-looking statements. In addition, in some cases, you can identify forward-looking statements by words or phrases such as "trend," "opportunity," "comfortable," "anticipate," "current," "intention," "position," "assume," "outlook," "remain," "maintain," "sustain," "seek," "achieve," and similar expressions.

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

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

3

Table of Contents

and other factors are found in "Item 1A. Risk Factors" in Part II and elsewhere in this Quarterly Report on Form 10-Q, the Annual Report on Form 10-K for the year ended December 31, 2014, as amended, and other reports and documents we file with the Securities and Exchange Commission (the "SEC") and include, without limitation, the following:

- consequences of the termination of Mr. Charney, our former chief executive officer (or the internal investigation related thereto), including any litigation or regulatory investigations, any alleged actions of Mr. Charney, or any impact on our sales or brand related thereto;
- changes in key personnel, our ability to hire and retain key personnel, and our relationship with our employees;
- voting control by our directors, lenders and other affiliates, including Standard General Group and Mr. Charney;
- ability to successfully implement our strategic, operating, financial and personnel initiatives;
- ability to maintain the value and image of our brand and protect our intellectual property rights;
- general economic conditions, geopolitical events, other regulatory changes, and inflation or deflation;
- disruptions in the global financial markets;
- the highly competitive and evolving nature of our industry in the U.S. and internationally;
- risks associated with fluctuations and trends of consumer apparel spending in the U.S.;
- changes in consumer preferences or demand for our products;
- our ability to attract customers to our retail and online stores;
- loss or reduction in sales to wholesale or retail customers or financial nonperformance by our wholesale customers;
- seasonality and fluctuations in comparable store sales and wholesale net sales and associated margins;
- ability to improve manufacturing efficiency at our production facilities;
- changes in the price of materials and labor, including increases in the price of raw materials in the global market and minimum wages;
- ability to pass on the added cost of raw materials and labor to customers;
- ability to effectively manage inventory levels;
- risks that our suppliers or distributors may not timely produce or deliver products;
- ability to renew leases on economic terms;
- risks associated with our facilities being concentrated in one geographic area;
- ability to identify new store locations and the availability of store locations at appropriate terms; ability to negotiate new store leases effectively; and ability to open new stores and expand internationally;
- ability to generate or obtain from external sources sufficient liquidity for operations and debt service;
- consequences of our significant indebtedness, including our relationships with lenders, ability to comply with debt agreements, ability to generate cash flow to service our debt, and the risk of acceleration of borrowings thereunder as a result of noncompliance;
- adverse changes in our credit ratings and any related impact on financial costs and structure;
- continued compliance with U.S. and foreign government regulations and legislation, including environmental, immigration, labor, and occupational health and safety laws and regulations;
- loss of U.S. import protections or changes in duties, tariffs and quotas, risks associated with our foreign operations and supply sources such as market disruption, changes in import and export laws, and currency restrictions and exchange rate fluctuations;
- litigation and other inquiries and investigations, including the risks that we, our officers or directors in cases where indemnification applies, will not be successful in defending any proceedings, lawsuits, disputes, claims or audits, and that exposure could exceed expectations or insurance coverage;
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tax assessments by domestic or foreign governmental authorities, including import or export duties on our products and the applicable rates for any such taxes or duties;
- ability to maintain compliance with the exchange rules of the NYSE MKT LLC;
- the adoption of new accounting standards or changes in interpretations of accounting principles;
- adverse weather conditions or natural disaster, including those which may be related to climate change;
- technological changes in manufacturing, wholesaling, or retailing;

Table of Contents

- the risk, including costs and timely delivery issues associated therewith, that information technology systems changes may disrupt our supply chain or operations and could impact cash flow and liquidity, and ability to upgrade information technology infrastructure and other risks associated with the systems that operate our online retail operations; and
- the risk of failure to protect the integrity and security of our information systems and customers' information.

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

Table of Contents

PART I-FINANCIAL INFORMATION
Item 1. Financial Statements (unaudited)
American Apparel, Inc. and Subsidiaries
Consolidated Balance Sheets
(in thousands, except per share amounts)

	March 31, 2015	December 31, 2014
ASSETS	(unaudited)	
Current assets:		
Cash	$20,914	$8,343
Trade accounts receivable (net of allowances $353; $458)	21,915	25,298
Prepaid expenses and other current assets	13,258	16,442
Inventories, net	122,753	147,578
Income taxes receivable and prepaid income taxes	345	648
Deferred income taxes, net of valuation allowance	677	681
Total current assets	179,862	198,990
Property and equipment, net	44,168	49,317
Deferred income taxes, net of valuation allowance	2,256	2,194
Other assets, net	44,999	43,888
TOTAL ASSETS	$271,285	$294,389
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current liabilities:		
Cash overdraft	$2,167	$5,714
Revolving credit facilities and current portion of long-term debt	35,091	34,312
Accounts payable	33,582	35,554
Accrued expenses and other current liabilities	63,887	61,369
Fair value of warrant liability	11,731	19,239
Income taxes payable	1,881	2,063
Deferred income tax liability, current	1,215	1,045
Current portion of capital lease obligations	3,007	2,978
Total current liabilities	152,561	162,274
Long-term debt (net of unamortized discount $5,771; $5,965)	233,621	217,388
Capital lease obligations, net of current portion	1,217	1,982
Deferred tax liability	191	200
Deferred rent, net of current portion	12,461	13,346
Other long-term liabilities	15,540	14,715
TOTAL LIABILITIES	415,591	409,905
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' DEFICIT		
Preferred stock, $0.0001 par value per-share: authorized 1,000 shares; none issued	0	0
Common stock, $0.0001 par value per-share: authorized 230,000 shares; Issued 176,682; 176,566, Outstanding 176,261; 176,194	18	18
Additional paid-in capital	218,866	218,779
Accumulated other comprehensive loss	(9,368)	(6,915)
Accumulated deficit	(351,665)	(325,241)
Less: Treasury stock, 304 shares at cost	(2,157)	(2,157)

TOTAL STOCKHOLDERS' DEFICIT	(144,306)	(115,516)
TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT	$271,285	$294,389

See accompanying notes to condensed consolidated financial statements.

6

Table of Contents

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

	Three Months Ended March 31, 2015	2014
Net sales	$124,263	$137,096
Cost of sales	76,801	65,122
Gross profit	47,462	71,974
Selling and distribution expenses	45,472	54,062
General and administrative expenses (including related party charges of $155; $160)	24,862	24,909
Retail store impairment	58	499
Loss from operations	(22,930)	(7,496)
Interest expense	9,781	10,039
Foreign currency transaction loss	625	132
Unrealized gain on change in fair value of warrants	(7,508)	(12,667)
Other income	(141)	(8)
Loss before income taxes	(25,687)	(4,992)
Income tax provision	737	474
Net loss	$(26,424)	$(5,466)
Basic and diluted net loss per-share [a]	$(0.15)	$(0.05)
Weighted-average basic and diluted shares outstanding [a]	176,259	111,554
Net loss (from above)	$(26,424)	$(5,466)
Other comprehensive loss items:		
Foreign currency translation	(2,453)	(471)
Other comprehensive loss, net of tax	(2,453)	(471)
Comprehensive loss	$(28,877)	$(5,937)

(a) The dilutive impact of incremental shares is excluded from loss position in accordance with U.S. generally accepted accounting principles ("GAAP")

See accompanying notes to condensed consolidated financial statements.

Table of Contents

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

	Three Months Ended March 31,	
	2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from customers	$127,242	$136,815
Cash paid to suppliers, employees and others	(123,460)	(130,984)
Income taxes paid	(158)	(403)
Interest paid	(671)	(1,521)
Other	129	8
Net cash provided by operating activities	3,082	3,915
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(1,120)	(3,958)
Proceeds from sale of fixed assets	0	30
Net cash used in investing activities	(1,120)	(3,928)
CASH FLOWS FROM FINANCING ACTIVITIES		
Cash overdraft	(3,547)	(3,989)
Repayments of expired revolving credit facilities, net	0	(14,557)
Borrowings under current revolving credit facilities, net	781	0
Borrowings (repayments) of term loans and notes payable	14,997	(50)
Payments of debt issuance costs	(323)	(372)
Net proceeds from issuance of common stock	0	28,554
Payment of payroll statutory tax withholding on share-based compensation associated with issuance of common stock	0	(125)
Repayments of capital lease obligations	(736)	(137)
Net cash provided by financing activities	11,172	9,324
Effect of foreign exchange rate on cash	(563)	(1,304)
Net increase in cash	12,571	8,007
Cash, beginning of period	8,343	8,676
Cash, end of period	$20,914	$16,683

See accompanying notes to condensed consolidated financial statements.

Table of Contents

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

	Three Months Ended March 31,	
	2015	2014
RECONCILIATION OF NET LOSS TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Net loss	$(26,424)	$(5,466)
Depreciation and amortization of property and equipment, and other assets	5,332	6,715
Retail store impairment	58	499
Share-based compensation expense	103	1,115
Unrealized gain on change in fair value of warrants	(7,508)	(12,667)
Amortization of debt discount and deferred financing costs	742	597
Accrued interest paid-in-kind	1,062	1,030
Foreign currency transaction loss	625	132
Allowance for inventory shrinkage and obsolescence	(1,075)	121
Bad debt expense	77	139
Deferred income taxes	24	0
Deferred rent	(912)	(2,222)
Changes in cash due to changes in operating assets and liabilities:		
Trade accounts receivables	2,902	(420)
Inventories	23,895	5,445
Prepaid expenses and other current assets	2,853	2,288
Other assets	(1,816)	(235)
Accounts payable	(1,636)	2,424
Accrued expenses and other liabilities	4,701	4,349
Income taxes receivable / payable	79	71
Net cash provided by operating activities	$3,082	$3,915
NON-CASH INVESTING AND FINANCING ACTIVITIES		
Property and equipment acquired, and included in accounts payable	$77	$1,040

See accompanying notes to condensed consolidated financial statements.

Table of Contents

American Apparel, Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements
(in thousands, except per share amounts)
(unaudited)

Note 1. Organization and Business

American Apparel, Inc. including its subsidiaries (collectively the "Company") is a vertically-integrated manufacturer, distributor, and retailer of branded fashion basic apparel products and designs. The Company manufactures and sells clothing and accessories for women, men, children and babies. 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 directly to customers through its retail stores located in the U.S. and internationally. In addition, the Company operates an online retail e-commerce website. At March 31, 2015, the Company operated a total of 239 retail stores in 20 countries including the U.S. and Canada.

Company Highlights

Recent Developments - On May 11, 2015, the Company anticipates to announce that it has commenced a $10,000 "at-the-market" offering program. Under the program, the Company may, from time to time and at its discretion, offer and sell shares of its common stock having an aggregate gross sales price of up to $10,000. The Company intends to use the net proceeds generated through the program for working capital and general corporate purposes.

On March 6, 2015, a member appointed by Lion Capital LLP ("Lion") resigned from the Board of Directors (the "Board"), and on March 24, 2015, the Board elected a member designated by Lion to fill that vacancy.

Liquidity - As of March 31, 2015, the Company had $20,914 in cash, $35,080 outstanding on a $50,000 asset-backed revolving credit facility with Capital One Business Credit Corp. ("Capital One" and such facility, the "Capital One Credit Facility") and $11,179 of availability for additional borrowings. On May 6, 2015, the Company had $5,150 of availability for additional borrowings under the Capital One Credit Facility. On April 14, 2015, the Company paid $13,803 in interest on its senior secured notes (the "Notes").

On March 25, 2015, the Company entered into the Sixth Amendment to the Capital One Credit Facility ("the Sixth Amendment") which (i) waived any defaults under the Capital One Credit Facility due to the failure to meet the obligation to maintain the maximum leverage ratio and minimum adjusted EBITDA required for the measurement periods ended December 31, 2014, as defined in the credit agreement, (ii) waived the obligation to maintain the minimum fixed charge coverage ratios, maximum leverage ratios and minimum adjusted EBITDA required for the twelve months ending March 31, 2015, (iii) included provisions to permit the Company to enter into the Standard General Credit Agreement (as defined below), (iv) reset financial covenants relating to maintaining minimum fixed charge coverage ratios, maximum leverage ratios and minimum adjusted EBITDA and (v) permitted the Company to borrow $15,000 under the Standard General Credit Agreement.

Standard General informed the Company that it entered into an agreement with Capital One that could result in it purchasing all of the loans and commitments outstanding under the Capital One Credit Facility by September 30, 2015 or earlier under certain other circumstances.

On March 25, 2015, one of the Company's subsidiaries borrowed $15,000 under an unsecured credit agreement with Standard General Group ("Standard General"), dated as of March 25, 2015 (the "Standard General Credit Agreement"). The Standard General Credit Agreement is guaranteed by the Company, bears interest at 14% per annum, and will mature on October 15, 2020. The proceeds of such loan provided additional liquidity to the Company as contemplated by the Nomination, Standstill and Support Agreement, dated July 9, 2014 (the "Standstill Agreement").

The Company believes that it has sufficient financing commitments to meet funding requirements for the next twelve months.

Management's Plan - In accordance with the Standstill Agreement, five new directors joined the Company in August 2014. Subsequently, the Board hired new senior management, including the Chief Executive Officer ("CEO"), Chief Financial Officer ("CFO"), and General Counsel, as well as other additions to the management team. Together, the new board of directors and new management team are focused on implementing a turnaround strategy and enhancing the Company's corporate governance policies and practices. The Company has started implementing additional operational and financial processes and disciplines to improve liquidity and profitability. To that end, the Company added new members to the executive team in the areas of planning and forecasting, operations, marketing, merchandising planning, product development and e-commerce. The Company continues to drive productivity from its distribution center, reduce inventory, reduce labor costs, and consolidate its administrative and manufacturing functions. Additionally, new members were added to the legal and human resources departments and the Company has introduced a new code of ethics.

Table of Contents

Although the Company has made progress under these programs, the Company operates in a rapidly evolving and often unpredictable business environment that may change the timing or amount of expected future cash receipts and expenditures. The Company's cash flows are dependent upon meeting future sales growth projections and reducing certain expenses. Accordingly, there can be no assurance that the Company's planned operational improvements will be successful.

Note 2. Summary of Significant Accounting Policies

Principles of Consolidation and Basis of Presentation

The condensed consolidated financial statements include the accounts of American Apparel, Inc. and its 100% owned subsidiaries. The condensed consolidated financial statements have been prepared in accordance with 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. All intercompany balances and transactions have been eliminated upon consolidation.

The financial data of the Company included herein is unaudited. The condensed consolidated financial statements do not contain certain information that was included in the annual financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2014. Readers are urged to review the Company's Annual Report on Form 10-K for the year ended December 31, 2014 as well as other publicly filed documents for more complete descriptions and discussions. In the opinion of management, the 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.

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 and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements, and the 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, inventory valuation and obsolescence; valuation and recoverability of long-lived assets, including the values assigned to goodwill, intangible assets, and property and equipment; fair value calculations, including derivative liabilities; contingencies, including accruals for the outcome of current litigation and assessments and self-insurance; and income taxes, including uncertain income tax positions and recoverability of deferred income taxes and any limitations as to net operating losses ("NOL"). Actual results could differ from those estimates.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentration of 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. Cash is managed within established guidelines, and the Company mitigates its risk by investing through major financial institutions. The Company had approximately $19,665 and $6,361 held in foreign banks at March 31, 2015 and December 31, 2014, respectively.

Concentration of credit risk with respect to trade accounts receivable is limited by performing on-going credit evaluations of its customers and adjusting credit limits based upon payment history and the customer's current credit worthiness. 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. Two customers in the Company's U.S. Wholesale segment combined accounted for 36.0% of its total trade accounts receivable as of March 31, 2015. One customer in the Company's U.S. Wholesale segment combined accounted for 16.6% of its total trade accounts receivable as of December 31, 2014. 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.

11

Table of Contents

Fair Value Measurements

The financial instruments recorded in the consolidated balance sheets include cash, trade accounts receivable (including credit card receivables), accounts payable, revolving credit facilities, senior secured notes, term loans and warrants. Due to their short-term maturity, the carrying values of cash, trade accounts receivables, and accounts payable approximate their fair market values. In addition, the carrying amount of the revolving credit facility from Capital One approximates its fair value because of the variable market interest rate charged to the Company.

The Company employs a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The fair value of a financial instrument is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date using the exit price. Accordingly, when market observable data is not readily available, the Company's own assumptions are used to reflect those that market participants would be presumed to use in pricing the asset or liability at the measurement date. Assets and liabilities recorded on the consolidated balance sheets at fair value are categorized based on the level of judgment associated with inputs used to measure their fair value and the level of market price observability, as follows:

Level 1 – Unadjusted quoted prices are available in active markets for identical assets or liabilities as of the reporting date.

Level 2 – Pricing inputs are other than unadjusted quoted prices in active markets, which are based on the following:

•Quoted prices for similar assets or liabilities in active markets;

•Quoted prices for identical or similar assets or liabilities in non-active markets; or

•Either directly or indirectly observable inputs as of the reporting date.

Level 3 – Pricing inputs are unobservable and significant to the overall fair value measurement, and the determination of fair value requires significant management judgment or estimation. The valuation policies and procedures underlying are determined by the Company's accounting and finance team and are approved by the CFO.

In certain cases, inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. Thus, a Level 3 fair value measurement may include inputs that are observable (Level 1 or Level 2) and unobservable (Level 3). The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and consideration of factors specific to the asset or liability.

The Company uses prices and inputs that are current as of the measurement date, including during periods of market disruption. In periods of market disruption, the ability to observe prices and inputs may be reduced for many instruments. This condition could cause an instrument to be reclassified from Level 1 to Level 2, or from Level 2 to Level 3. The Company recognizes transfers between levels at either the actual date of the event or a change in circumstances that caused the transfer.

As of March 31, 2015, there were no transfers between Levels 1, 2, and 3 of the fair value hierarchy.

Summary of Significant Valuation Techniques

Level 2 Measurements:

Senior secured notes: Estimated based on quoted prices for identical senior secured notes in non-active market.

Level 3 Measurements:

Term loans: Estimated using a projected discounted cash flow analysis based on unobservable inputs including principal and interest payments and discount rate. A yield rate was estimated using yields rates for publicly traded debt instruments of comparable companies with similar features. An increase or decrease in the stock price and the discount rate assumption can significantly decrease or increase the fair value of team loans. See Note 8.

Warrants: Estimated using the Binomial Lattice option valuation model. Significant observable and unobservable inputs include stock price, exercise price, annual risk free rate, term, and expected volatility. An increase or decrease in these inputs could significantly increase or decrease the fair value of the warrant. See Notes 8 and 11.

Indefinite-lived assets - goodwill: Estimated 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. An increase or decrease in the discount rate assumption and/or the terminal value assumption, in isolation, can have a significant effect on the fair value of the reporting unit.

Retail stores: Estimated using a projected discounted cash flow analysis based on unobservable inputs including gross profit and discount rate. The key assumptions used in the estimates of projected cash flows were sales, gross margins, and payroll costs.

Table of Contents

These forecasts were based on historical trends and take into account recent developments as well as the Company's plans and intentions. An increase or decrease in the discount rate assumption and/or projected cash flows, in isolation, can significantly decrease or increase the fair value of the assets, which would have an effect on the impairment recorded.

Income Taxes

Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial reporting basis and the respective tax basis of its assets and liabilities, and are measured 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. Significant weight is given to evidence that can be objectively verified. The determination to record a valuation allowance is based on the recent history of cumulative losses and current operating performance and includes an assessment of the degree to which any losses are driven by items that are unusual in nature or incurred to improve future profitability. In addition, the Company reviews changes in near-term market conditions and any other factors arising during the period which may impact its future operating results. 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. Management believes that adequate provisions have been made for all years, but the outcome of tax audits cannot be predicted with certainty. If any issues addressed in the Company's tax audits are resolved in a manner not consistent with management’s expectations, the Company could be required to adjust its provision for income tax in the period such resolution occurs.

The Company's foreign domiciled subsidiaries are subject to foreign income taxes on earnings in their respective jurisdictions. The Company elected to have its foreign subsidiaries, except for its subsidiaries in Brazil, Canada, China, Ireland, Italy, South Korea, and Spain, consolidated in the Company's U.S. federal income tax return. The Company is generally eligible to receive tax credits on its U.S. federal income tax return for most of the foreign taxes paid by the Company's subsidiaries included in the U.S. federal income tax return.

For financial statement purposes, the Company recognizes tax benefits from uncertain tax positions only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. Once this threshold has been met, the Company's measurement of its expected tax benefits is recognized in its financial statements. Gross unrecognized tax benefits are included in current liabilities in the consolidated balance sheets, and interest and penalties on unrecognized tax benefits are recorded in the income tax provision in the consolidated statements of operations.

Recently Issued Accounting Standards

In April 2015, the Financial Accounting Standards Board ("FASB") issued a new standard that requires an entity to determine whether a cloud computing arrangement contains a software license. If the arrangement contains a software license, the entity would account for the fees related to the software license element in a manner consistent with how the acquisition of other software licenses is accounted for. If the arrangement does not contain a software license, the customer would account for the arrangement as a service contract. The new standard will be effective for fiscal years beginning after December 15, 2015, and interim periods in fiscal years beginning after December 15, 2016. The Company is in the process of evaluating the impact of adoption on the Company's consolidated financial statements.

In April 2015, the FASB issued a new standard on simplifying the presentation of debt issuance costs. The new standard requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this new standard. The new standard will be effective for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. The Company is in the process of evaluating the impact of adoption on the Company's consolidated financial statements.

Other recently issued accounting standards are not expected to have a material effect on the Company's consolidated financial statements.

13

Table of Contents

Note 3. Inventories

The components of inventories are as follows:

	March 31, 2015	December 31, 2014
Raw materials	$16,131	$17,738
Work in process	3,279	2,805
Finished goods	111,007	135,813
	130,417	156,356
Less reserve for inventory shrinkage and obsolescence	(7,664)	(8,778)
Total, net of reserves	$122,753	$147,578

Inventories consist of material, labor, and overhead, and are stated at the lower of cost or market. Cost is primarily determined on the first-in, first-out (FIFO) method. No supplier provided more than 10% of the Company's raw material purchases as of March 31, 2015 and December 31, 2014.

The Company identifies potentially excess and slow-moving inventories by evaluating turn rates, inventory levels and other factors and records lower of cost or market reserves for such identified excess and slow-moving inventories. The Company also establishes reserves for inventory shrinkage for each of its retail locations and warehouse based on the historical results of physical inventory cycle counts.

The Company had a lower of cost or market reserves for excess and slow-moving inventories of $6,653 and $6,684 at March 31, 2015 and December 31, 2014, respectively. As part of its valuation analysis of inventory, the Company identified certain slow-moving, second quality finished goods and raw materials inventory for additional reserves in the fourth quarter of 2014. Inventory shrinkage reserves were $1,011 and $2,094 as of March 31, 2015 and December 31, 2014, respectively.

Note 4. Property and Equipment

Depreciation and amortization expense relating to property and equipment (including capitalized leases) is recorded in cost of sales and general and administrative expenses in the consolidated statements of operations. Depreciation and amortization expenses were $5,332 and $6,715 for the three months ended March 31, 2015 and 2014, respectively. Based on its retail store impairment analysis, the Company recorded impairment charges of $58 and $499 for the three months ended March 31, 2015 and 2014.

Note 5. Accrued Expenses and Other Current Liabilities

The components of accrued expenses and other current liabilities are as follows:

	March 31, 2015	December 31, 2014
Compensation, bonuses and related taxes	$13,466	$13,026
Accrued interest	13,239	5,932
Workers' compensation and other self-insurance reserves (Note 14)	7,164	6,760
Taxes and duties	4,263	6,102
Gift cards and store credits	7,266	8,462
Loss contingencies	1,753	2,360
Deferred revenue	948	962
Deferred rent	3,016	3,422
Other	12,772	14,343
Total accrued expenses and other current liabilities	$63,887	$61,369

Table of Contents

Note 6. Revolving Credit Facilities and Current Portion of Long-Term Debt
The following table presents revolving credit facilities and current portion of long-term debt:

	Lender	Expiration	March 31, 2015	December 31, 2014
Revolving credit facility	Capital One	April 14, 2018	$35,080	$34,299
Current portion of long-term debt			11	13
Total			$35,091	$34,312

The Company incurred interest expense of $9,781 and $10,039 for the three months ended March 31, 2015 and 2014, respectively, for all outstanding borrowings. The interests subject to capitalization were not significant for the three months ended March 31, 2015 and 2014.

Revolving Credit Facility - Capital One

The Company had $35,080 and $34,299 outstanding on a $50,000 asset-backed revolving credit facility with Capital One as of March 31, 2015 and December 31, 2014, respectively. The amount available for additional borrowings on March 31, 2015 was $11,179. The Capital One Credit Facility matures on April 14, 2018 and is subject to a January 15, 2018 maturity if excess availability is less than $15,000 at the time of notice to Capital One that an "applicable high yield discount obligation" redemption will be required pursuant to Section 3.01(e) of the Indenture governing the Notes. The interest rates on borrowings under the Capital One Credit Facility are equal to LIBOR plus 5.0% or the bank's prime rate plus 4.0% at the Company's option and are subject to specified borrowing requirements and covenants.

On March 25, 2015, the Company entered into the Six Amendment which (i) waived any defaults under the Capital One Credit Facility due to the failure to meet the obligation to maintain the maximum leverage ratio and minimum adjusted EBITDA required for the measurement periods ended December 31, 2014, as defined in the credit agreement, (ii) waived the obligation to maintain the minimum fixed charge coverage ratios, maximum leverage ratios and minimum adjusted EBITDA required for the twelve months ended March 31, 2015, (iii) included provisions to permit the Company to enter into the Standard General Credit Agreement, (iv) reset financial covenants relating to maintaining minimum fixed charge coverage ratios, maximum leverage ratios and minimum adjusted EBITDA and (v) permitted the Company to borrow $15,000 under the Standard General Credit Agreement.

Standard General informed the Company that it entered into an agreement with Capital One that could result in it purchasing all of the loans and commitments outstanding under the Capital One Credit Facility by September 30, 2015 or earlier under certain other circumstances.

The Capital One Credit Facility is secured by a lien on substantially all of the assets of the Company's domestic subsidiaries and equity interests in certain of the Company's foreign subsidiaries, subject to some restrictions. It requires that the Company maintain a lockbox arrangement and contains certain subjective acceleration clauses. In addition, Capital One may adjust the advance restriction and criteria for eligible inventory and accounts receivable at its discretion. The Capital One Credit Facility contains cross-default provisions whereby an event of default under the Senior Notes Indenture (the "Indenture") or other indebtedness, in each case of an amount greater than a specified threshold, would cause an event of default under the Capital One Credit Facility. As of March 31, 2015, the Company had $1,080 of outstanding letters of credit secured against the Capital One Credit Facility.

Table of Contents

Note 7. Long-Term Debt

Long-term debt consists of the following:

	March 31, 2015	December 31, 2014
Senior Secured Notes due 2020 [(a)]	$209,315	$208,084
Standard General Loan Agreement [(b)]	9,074	9,049
Standard General Credit Agreement	15,000	0
Other	243	268
Total long-term debt	233,632	217,401
Current portion of debt	(11)	(13)
Long-term debt, net of current portion	$233,621	$217,388

(a) Includes accrued interest paid in-kind of $8,295 and $7,233 and net of unamortized discount of $4,980 and $5,149 at March 31, 2015 and December 31, 2014, respectively.

(b) Net of unamortized discount of $791 and $816 at March 31, 2015 and December 31, 2014, respectively.

Senior Secured Notes due 2020

The Company has outstanding Notes issued at 97% of the $206,000 par value on April 4, 2013. The Notes mature on April 15, 2020 and bear interest at 15% per annum, of which 2% is payable in-kind until April 14, 2018 and in cash on subsequent interest dates. Interest on the Notes, of approximately $13,900 per payment period in 2015, is payable semi-annually, in arrears, on April 15 and October 15. On April 14, 2015, the Company paid $13,803 in interest on the Notes.

On or after April 15, 2017, the Company may, at its option, redeem some or all of the Notes at a premium, decreasing ratably over time to zero as specified in the Indenture, plus accrued and unpaid interest to, but not including, the redemption date. Prior to April 15, 2017, the Company may, at its option, redeem up to 35% of the aggregate principal amount of the Notes with the net cash proceeds of certain equity offerings at a redemption price of 113% of the aggregate principal amount of the redeemed notes plus accrued and unpaid interest to, but not including, the redemption date. In addition, at any time prior to April 15, 2017, the Company may, at its option, redeem some or all of the Notes by paying a "make whole" premium, plus accrued and unpaid interest to, but not including, the redemption date. If the Company experiences certain change of control events, the holders of the Notes will have the right to require the Company to purchase all or a portion of the Notes at a price in cash equal to 101% of the principal amount of such Notes, plus accrued and unpaid interest to, but not including, the date of purchase. In addition, the Company is required to use the net proceeds of certain asset sales, if not used for specified purposes, to purchase some of the Notes at 100% of the principal amount, plus accrued and unpaid interest to, but not including, the date of purchase. On each interest payment date after April 4, 2018, the Company will be required to redeem, for cash, a portion of each Note then outstanding equal to the amount necessary to prevent such Note from being treated as an "applicable high yield discount obligation" within the meaning of the Internal Revenue Code. The redemption price will be 100% of the principal amount plus accrued and unpaid interest thereon on the date of redemption.

The Notes are guaranteed, jointly and severally, on a senior secured basis by the Company's existing and future domestic subsidiaries. The Notes and the related guarantees are secured by a first-priority lien on the Company's and its domestic subsidiaries' assets (other than the Credit Facility Priority Collateral, as defined below, subject to some exceptions and permitted liens). The Notes and the related guarantees also are secured by a second-priority lien on all of Company's and its domestic subsidiaries' cash, trade accounts receivable, inventory and certain other assets (collectively, the "Credit Facility Priority Collateral"), subject to certain exceptions and permitted liens. The Notes and the guarantees, respectively, rank equal in right of payment with the Company's and its domestic subsidiaries' senior indebtedness, including indebtedness under the Capital One Credit Facility, before giving effect to collateral arrangements.

The Notes impose certain limitations on the ability of the Company and its domestic subsidiaries to, among other things, and subject to a number of important qualifications and exceptions, incur additional indebtedness or issue disqualified capital stock or preferred stock (with respect to restricted subsidiaries), grant liens, make payments in respect of their capital stock or certain indebtedness, enter into transactions with affiliates, create dividend or other payment restrictions affecting subsidiaries, merge or consolidate with any other person, sell, assign, transfer, lease, convey or otherwise dispose of all or substantially all of its assets or adopt a plan of liquidation. The Company must annually report to the trustee on compliance with such limitations. The Notes also contain cross-default provisions whereby a payment default or acceleration of any indebtedness in an aggregate amount greater than a specified threshold would cause an event of default with respect to the Notes.

As of March 31, 2015, the Company was in compliance with the required covenants of the Indenture.

Table of Contents

Standard General Loan Agreement

On July 16, 2014, Lion assigned its rights and obligations as a lender to an entity affiliated with Standard General (the "Standard General Loan Agreement"). On September 8, 2014, the Company entered into an amendment of the Standard General Loan Agreement to lower the applicable interest rate to 17%, extend the maturity to April 15, 2021, and make certain other technical amendments. The principal amount of the term loan is $9,865. Interest under the loan agreement is payable quarterly in cash or, to the extent permitted by the Company's other debt agreements, in-kind.

Standard General Credit Agreement

On March 25, 2015, as contemplated by the Standstill Agreement, one of the Company's subsidiaries borrowed $15,000 under the Standard General Credit Agreement. The Standard General Credit Agreement is guaranteed by the Company, bears interest at 14% per annum, and will mature on October 15, 2020. Interest under the credit agreement is payable quarterly in cash or, to the extent permitted by the Company's other debt agreements, in-kind.

The Standard General Credit Agreement contains customary defaults, including cross event of default to the Notes and the Standard General Loan Agreement and cross acceleration to other indebtedness above a threshold amount.

If the Company experiences certain change of control events, the Company is required to offer to prepay the Standard General Credit Agreement at 101% of the outstanding principal amount plus accrued and unpaid interest on the date of the prepayment. The Company will be required to prepay loans under the Standard General Credit Agreement to the extent necessary to avoid the loan being characterized as an "applicable high yield discount obligation" within the meaning of the Internal Revenue Code by June 30, 2020.

Note 8. Fair Value of Financial Instruments

The Company's financial instruments at fair value are measured on a recurring basis. Related unrealized gains or losses are recognized in unrealized gain on change in fair value of warrants in the consolidated statements of operations. For additional disclosures regarding methods and assumptions used in estimating fair values of these financial instruments, see Note 2.

The following tables present carrying amounts and fair values of the Company's financial instruments as of March 31, 2015 and December 31, 2014, and indicate the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value. The Company did not have any assets or liabilities categorized as Level 1 as of March 31, 2015.

		March 31, 2015	
		Carrying Amount	Fair Value
Senior Secured Notes due 2020	Level 2 Liability	$209,315	$217,164
Standard General Loan Agreement	Level 3 Liability	9,074	9,790
Standard General Credit Agreement	Level 3 Liability	15,000	15,000
Lion Warrant	Level 3 Liability	(a)	11,731
		$233,389	$253,685

		December 31, 2014	
		Carrying Amount	Fair Value
Senior Secured Notes due 2020	Level 2 Liability	$208,084	$211,538
Standard General Loan Agreement	Level 3 Liability	9,049	8,868
Lion Warrant			