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UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA
WESTERN DIVISION

 Individually
and on Behalf of All Others Similarly
Situating,

Plaintiff,

vs.

AMERICAN APPAREL, INC., DOV
CHARNEY, ADRIAN
KOWALEWSKI, MARTIN BAILEY
and JOYCE E. CRUCILLO,

Defendants.

VIA FAX
No. **CV10 6352** *MM (RC)*
CLASS ACTION

COMPLAINT FOR VIOLATION OF
THE FEDERAL SECURITIES LAWS

DEMAND FOR JURY TRIAL

1 **JURISDICTION AND VENUE**

2 1. The claims asserted herein arise under §§10(b), 14(a) and 20(a) of the
3 Securities Exchange Act of 1934 (“1934 Act”) and Rule 10b-5. Jurisdiction is
4 conferred by §27 of the 1934 Act. Venue is proper pursuant to §27 of the 1934 Act.
5 American Apparel, Inc.’s headquarters are located in Los Angeles, California. False
6 statements were made in this District and acts giving rise to the violations complained
7 of occurred in this District.

8 **INTRODUCTION AND OVERVIEW**

9 2. This is a class action for violations of the anti-fraud provisions of the
10 federal securities laws on behalf of all purchasers of American Apparel, Inc.
11 (“American Apparel” or the “Company”) common stock between December 20, 2006
12 and August 17, 2010, inclusive (the “Class Period”), and who were damaged thereby
13 (the “Class”).¹

14 3. American Apparel purports to be a vertically integrated manufacturer,
15 distributor, and retailer of branded fashion basic apparel. The Company designs,
16 manufactures and sells clothing for women, men, children and pets through retail,
17 wholesale and online distribution channels. American Apparel primarily
18 manufactures its apparel in Los Angeles. Throughout the Class Period, such
19 manufacturing was largely done using an undocumented immigrant workforce.
20 Investors were not informed of this fact nor of the risk it posed to American Apparel’s
21 future.

22 4. During the Class Period, defendants made false and misleading
23 statements about the Company’s hiring practices and the effect of such hiring
24 practices on the Company’s financial performance. Specifically, defendants falsely
25

26 ¹ Prior to December 13, 2007, American Apparel was known as Endeavor
27 Acquisition Corp. (“Endeavor”), which had entered into an agreement as of the
28 beginning of the Class Period to acquire American Apparel.

1 stated that they made “diligent efforts” to comply with employment and labor
2 regulations, and failed to disclose, and made false statements to shareholders
3 regarding, the effect of the Company’s illegal hiring practices on its operating costs
4 and margins.

5 5. Beginning in July 2009, after the Company revealed that it was being
6 investigated by U.S. Immigration and Customs Enforcement (“ICE”) regarding its
7 compliance with U.S. immigration law, the true financial condition of the Company
8 began to be revealed. However, defendants assured investors that such investigation
9 would not have a material effect on American Apparel.

10 6. On May 19, 2010, the Company issued a press release entitled “American
11 Apparel Reports Preliminary First Quarter 2010 Financial Results.” The release
12 detailed that the Company’s operating losses had skyrocketed, while its gross margins
13 had plummeted, in substantial part due to a reduction in labor efficiency as “a result of
14 the dismissal of over 1,500 experienced manufacturing employees in the third and
15 fourth quarters of 2009 following the completion of an I-9 inspection by [ICE].” The
16 release stated in part:

17 Gross margin for the first quarter of 2010 was 50.4% as compared
18 to 57.2% for the prior year first quarter. Gross margin was negatively
19 impacted by a shift in mix from retail to wholesale net sales, which
20 generate lower margins, and by *reduced labor efficiency at the*
21 *company’s production facilities in the first quarter of 2010 compared*
22 *to the prior year period. The reduction in labor efficiency was a result*
23 *of the dismissal of over 1,500 experienced manufacturing employees in*
24 *the third and fourth quarters of 2009 following the completion of an I-*
25 *9 inspection by U.S. Immigration and Customs Enforcement, as well as*
26 *the impact of an increase in the mix of more complex retail styles*
27 *produced.*

28 * * *

1 *For the first quarter of 2010, the impact of lower manufacturing*
2 *efficiency is estimated to have reduced operating income by*
3 *approximately \$4.4 million. The company currently expects that the*
4 *reduced manufacturing efficiency at the company's production*
5 *facilities beginning during the fourth quarter of 2009 could likely*
6 *continue through the end of 2010, and could impact the company's*
7 *financial results at least through early 2011.*

8 7. As a result of this disclosure, American Apparel's stock price plummeted
9 41% in one day, on trading volume of over 2.8 million shares – over 7 times higher
10 than the Company's average. But the worst was not over for American Apparel
11 shareholders.

12 8. On July 28, 2010, the Company filed a Form 8-K with the United States
13 Securities and Exchange Commission ("SEC"). The Form 8-K announced that
14 Deloitte and Touche, LLP, the Company's independent registered public accountant,
15 had resigned effective July 22, 2010. The Form 8-K further stated that "Deloitte
16 advised the Company that certain information has come to Deloitte's attention, that if
17 further investigated may materially impact the reliability of either its previously issued
18 audit report or the underlying consolidated financial statements for the year ended
19 December 31, 2009 included in the Company's 2009 Form 10-K."

20 9. On August 17, 2010, the Company issued a press release entitled
21 "American Apparel Reports Preliminary Second Quarter 2010 Financial Results."
22 The press release reported that the Company expected to report a loss of \$5 million to
23 \$7 million in the second quarter of 2010 on net sales of \$132 million to \$143 million.
24 A significant factor in such losses was "lower labor efficiency at the Company's
25 production facilities in the second quarter of 2010 compared to the prior year period.
26 The lower labor efficiency was primarily a result of the hiring of over 1,600 net new
27 manufacturing workers during the second quarter of 2010."
28

1 10. The August 17, 2010, press release also stated that as results of the
2 Company's poor performance, its very existence was now in doubt:

3 The Company expects to report a substantial loss from operations
4 and negative cash flows from operating activities for the six months
5 ended June 30, 2010. Based on this, and trends occurring in the
6 Company's business after the second quarter and projected for the
7 remainder of 2010, *the Company may not have sufficient liquidity*
8 *necessary to sustain operations for the next twelve months.* The
9 Company's current operating plan indicates that losses from operations
10 are expected to continue through at least the third quarter of 2010. These
11 factors, among others, *raise substantial doubt that the Company will be*
12 *able to continue as a going concern.*

13 11. By August 18, 2010, as this news was digested by the market, American
14 Apparel's stock price had declined rapidly, from a close of \$1.39 per share on August
15 16, 2010, to a close of just \$0.81 per share on August 18, 2010 – a decline of over
16 41%

17 THE PARTIES

18 12. Plaintiff [REDACTED] purchased American Apparel common stock
19 during the Class Period as set forth in the attached certification and was damaged
20 thereby.

21 13. Defendant American Apparel purports to be a vertically integrated
22 manufacturer, distributor, and retailer of branded fashion basic apparel. The Company
23 designs, manufactures and sells clothing for women, men, children and pets through
24 retail, wholesale and online distribution channels. As of December 31, 2009, the
25 Company operated 281 retail stores in 20 countries. The Company also operates a
26 wholesale business, which is a leading supplier of T-shirts and other casual wear to
27 screen printers and distributors. American Apparel went public through a reverse
28 merger with Endeavor, which had gone public as a shell corporation in 2005.

1 14. Defendant Dov Charney (“Charney”) has served as Chairman of the
2 Board, Chief Executive Officer, President and a director of American Apparel since
3 December 12, 2007. Previously, Charney was founder, a director, Chief Executive
4 Officer and President of Old American Apparel (the Company’s predecessor) and its
5 predecessor companies since their formation in Columbia, South Carolina, in 1989.

6 15. Defendant Adrian Kowalewski (“Kowalewski”) is the Company’s
7 Executive Vice President and Chief Financial Officer. From June 2006 to December
8 2008, Kowalewski served as the Company’s Director of Corporate Finance and
9 Development, where his responsibilities included finance, corporate strategy, and
10 investor relations. Kowalewski has been a director of the Company since
11 December 12, 2007.

12 16. Defendant Martin Bailey (“Bailey”) has served as Chief Manufacturing
13 Officer of the Company since December 12, 2007. Previously, Bailey had served as
14 President of Manufacturing of Old American Apparel since 2002, overseeing
15 operations of textile and apparel production and the planning, purchasing, sourcing,
16 product development, quality-assurance and distribution departments, as well as non-
17 related support departments.

18 17. Defendant Joyce E. Crucillo (“Crucillo”) has served as Chief Litigation
19 Counsel of American Apparel since February 17, 2009. As Chief Litigation Counsel,
20 Crucillo heads the Company’s trial team in all aspects of American Apparel’s
21 litigation matters. In addition, Crucillo is responsible for ensuring the Company’s
22 compliance with governmental regulatory requirements, handling employment-related
23 claims, and advising management and the Board of Directors on various legal matters.
24 Crucillo served as the Company’s General Counsel until 2009 and previously served
25 as General Counsel of Old American Apparel starting in December 2006.

26 18. The defendants referenced above in ¶¶14-17 are referred to herein as the
27 “Individual Defendants.”

28

1 19. The Individual Defendants, because of their positions with the Company,
2 possessed the power and authority to control the contents of American Apparel's
3 quarterly reports, press releases and presentations to securities analysts, money and
4 portfolio managers and institutional investors, *i.e.*, the market. They were provided
5 with copies of the Company's reports and press releases alleged herein to be
6 misleading prior to or shortly after their issuance and had the ability and opportunity
7 to prevent their issuance or cause them to be corrected. Because of their positions
8 with the Company, and their access to material non-public information available to
9 them but not to the public, the Individual Defendants knew that the adverse facts
10 specified herein had not been disclosed to and were being concealed from the public
11 and that the positive representations being made were then materially false and
12 misleading. The Individual Defendants are liable for the false statements pleaded
13 herein.

14 20. American Apparel was founded in 1989 by defendant Charney.
15 American Apparel became a public company in December 2007 through a reverse
16 merger. On December 19, 2006, American Apparel announced a merger with
17 Endeavor, a "special-purpose acquisition company" formed for the sole purpose of
18 seeking out private companies and taking them public. This reverse merger was
19 completed in December 2007, and Endeavor immediately changed its name to
20 American Apparel.

21 21. Since 2000, American Apparel's primary manufacturing facility has been
22 an 800,000-square-foot factory located in downtown Los Angeles, where it employs
23 thousands of people in manufacturing its t-shirts and garments. For a garment
24 company, American Apparel enjoyed high gross profit margins. In 2007, American
25 Apparel had an 80% gross margin, well above the industry average of 60%.

26 22. However, in 2009 and 2010, the Company's margins were crippled after
27 it was revealed that a third of its manufacturing staff in Los Angeles could not verify
28 their eligibility for employment in the United States. Indeed, after the investigation by

1 ICE was completed, the Company announced that it had been employing such
2 workers for as long as ten years. Having been forced to fire a third of its
3 manufacturing staff, the Company's operations were thrown into disarray, threatening
4 its very existence.

5 **FALSE AND MISLEADING**
6 **STATEMENTS DURING THE CLASS PERIOD**

7 23. On December 20, 2006, Endeavor filed a Form 8-K with the SEC
8 announcing that, on December 18, 2006, Endeavor had entered into an agreement and
9 plan of reorganization by which it would acquire American Apparel and its affiliated
10 companies. The Form 8-K stated that Endeavor had received representations and
11 warranties regarding a number of issues related to American Apparel's business,
12 including:

13 The Agreement contains representations and warranties of each of
14 American Apparel and Endeavor relating to, among other things,
15 (a) proper corporate organization and similar corporate matters, . . .
16 (f) financial information and absence of undisclosed liabilities, . . .
17 (l) employee matters, (m) compliance with laws, [and] (n) compliance
18 with applicable provisions of securities laws

19 24. The December 20, 2006 Form 8-K included a press release issued by
20 American Apparel which discussed its employees:

21 All manufacturing is done under one roof at its downtown Los Angeles
22 factory and headquarters. Committed to its employees as crucial
23 components of the Company's success and stability as well as the quality
24 of its garments, American Apparel is a leader in employer/employee
25 relations, offering benefits to all employees.

26 25. On January 23, 2007, American Apparel issued a press release entitled
27 "American Apparel Announces \$41 Million Debt Financing." Defendant Charney
28 was quoted in the release:

1 “As the first major investment of institutional capital into
2 American Apparel, this financing represents an important validation of
3 our vertically-integrated business model This transaction places the
4 company on a firm financial footing and allows us to pursue our
5 ambitious growth plans, as well as our proposed merger with Endeavor
6 Acquisition Corp. The hard work and dedication of our employees, and
7 the support of our customers, vendors, and creditors, have been critical
8 during American Apparel’s rapid growth.”

9 26. On April 4, 2007, Endeavor issued a press release entitled “Endeavor
10 Acquisition Corp. Announces Transaction with American Apparel to Move Forward,”
11 which stated that American Apparel had advised Endeavor that it would post at least
12 \$30 million for the fiscal year ending December 31, 2006 in adjusted Earnings Before
13 Interest, Taxes, Depreciation, Amortization after giving effect to one-time charges
14 (“pro forma adjusted EBITDA”). This satisfied terms of the merger agreement
15 wherein American Apparel was required to demonstrate pro forma adjusted EBITDA
16 of at least \$30 million for the fiscal year ending December 31, 2006.

17 27. The release quoted Charney:
18 “I am pleased that American Apparel continues to flourish with strong
19 same store sales this quarter. The merger with Endeavor will provide the
20 equity capital necessary to fuel our continued growth and expansion of
21 our operations in several of the most influential metropolitan centers
22 around the world Until the merger is completed, we continue to
23 prepare the company for this influx of capital,” said Charney.

24 28. On June 11, 2007, Endeavor filed a preliminary merger proxy statement
25 with the SEC. The proxy statement reported that American Apparel’s workers were
26 documented and authorized to work in the United States:

27
28

1 *Many of American Apparel's workers are documented*
2 *immigrants and authorized to work in the United States; however,*
3 *changes in immigration and labor laws could affect such labor force.*

4 Many of American Apparel's workers are documented
5 immigrants, authorized to work in the United States. Changes to existing
6 U.S. immigration laws or labor laws could affect this labor force and
7 could make it harder for members of such force to remain or legally
8 work in the United States. Any changes in U.S. laws having such an
9 affect could make it harder for American Apparel to maintain and
10 expand its work force, which would be adverse to American Apparel's
11 manufacturing capabilities and harm American Apparel's operations and
12 financial results.

13 29. On August 20, 2007, Endeavor filed a preliminary revised proxy
14 statement with the SEC, which repeated that American Apparel's workers were
15 documented and authorized to work in the United States:

16 Many of American Apparel's workers are documented immigrants
17 and authorized to work in the United States; however, changes in
18 immigration and labor laws could affect such labor force.

19 Many of American Apparel's workers are documented
20 immigrants, authorized to work in the United States. Changes to existing
21 U.S. immigration laws or labor laws could affect this labor force and
22 could make it harder for members of such force to remain or legally
23 work in the United States. Any changes in U.S. laws having such an
24 affect could make it harder for American Apparel to maintain and
25 expand its work force, which would be adverse to American Apparel's
26 manufacturing capabilities and harm American Apparel's operations and
27 financial results.

28

1 am very excited about the growth that the company has experienced so
2 far this year. Despite a challenging retail environment, the second
3 quarter was the most successful period in American Apparel's history.
4 We are pleased that our product offering has appealed to so many
5 customers and we are eager to introduce the vibrant, emerging brand we
6 have developed to metropolitan adults around the world. In the months
7 ahead, we look forward to building upon the strong financial
8 performance of the first half of 2007."

9 "The fortuitous timing of our refinancing this past July is
10 providing us with the liquidity to continue to enhance the value of the
11 American Apparel business, while we work patiently towards closing the
12 merger with Endeavor," added Adrian Kowalewski, American Apparel's
13 Director of Corporate Finance and Development.

14 33. On November 12, 2007, Endeavor issued a press release entitled
15 "Endeavor Acquisition Corp. Reports American Apparel's Third Quarter 2007
16 Financial Results," which stated in part:

17 American Apparel reported unaudited combined sales for the 2007
18 third quarter ended September 30, 2007 of \$106.5 million, a 34%
19 increase over sales of \$79.4 million for the three month period ended
20 September 30, 2006. Retail sales increased 43% to \$55.9 million for the
21 third quarter of 2007 as compared to \$39.1 million for the same period in
22 2006, with same-store sales for stores open at least 12 months rising
23 27%. At September 30, 2007, American Apparel had 165 stores as
24 compared to 142 stores at September 30, 2006. Wholesale results were
25 \$50.6 million for the 2007 third quarter as compared to \$40.3 million for
26 the 2006 third quarter, an increase of 25%.

27 * * *

1 Dov Charney, Chief Executive Officer of American Apparel
2 stated: "I am very proud of the financial results we have delivered in the
3 third quarter, which were made possible by the important contributions
4 of everyone at the company. I look forward to the completion of our
5 merger with Endeavor which will result in American Apparel becoming
6 a public company, and will allow our employees and the public to share
7 in the future success of our business."

8 34. On March 17, 2008, the Company issued a press release entitled
9 "American Apparel Reports Fourth Quarter and Full Year 2007 Financial Results –
10 Fourth quarter 2007 net sales of \$111.2 million up 48% over the fourth quarter of
11 2006." In the press release, the Company reported:

12 — Net income for the fourth quarter of 2007 of \$3.0 million versus a
13 loss of \$1.5 million in the fourth quarter of 2006; net income for 2007 of
14 \$15.5 million, compared to a net loss of \$1.6 million in 2006.

15 35. Also on March 17, 2008, the Company filed a Form 10-K with the SEC
16 for the year ended December 31, 2007. In the 2007 Form 10-K, the Company
17 reported its gross profit and operating expenses as follows:

18 **Gross Profit:** Gross profit increased from \$145.6 million for the
19 year ended December 31, 2006 to \$215.5 million for the year ended
20 December 31, 2007, which represents an increase of 48.0%. The overall
21 increase in gross profit is a result of growth in retail sales which realize
22 higher margins. This increase in gross profit is also a result of an
23 increased amount of sales being generated from the International
24 segments and the portion of the U.S. Wholesale segment related to
25 online sales. In the International segment, there was growth in online
26 sales and the addition of new retail stores contributed to sales which
27 generated higher margins.

28

1 **Operating Expenses:** The following table sets forth American
 2 Apparel's operating expenses for the year ended December 31, 2007 as
 3 compared to December 31, 2006.

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

9 36. The 2007 Form 10-K also discussed the Company's compliance with
 10 immigration regulations in the hiring of employees, stating that "*[t]he Company*
 11 *makes diligent efforts to comply with all employment and labor regulations,*
 12 *including immigration laws, in the many jurisdictions in which the Company*
 13 *conducts operations.*"

14 37. The 2007 Form 10-K was accompanied by certifications signed by
 15 defendant Charney and the Company's CFO, Ken Cieply ("Cieply"), which stated:

16 I, [Charney/Cieply], certify that:

17 1. I have reviewed this annual report on Form 10-K of
 18 American Apparel, Inc.;

19 2. Based on my knowledge, this report does not contain any
 20 untrue statement of a material fact or omit to state a material fact
 21 necessary to make the statements made, in light of the circumstances
 22 under which such statements were made, not misleading with respect to
 23 the period covered by this report;

24 3. Based on my knowledge, the financial statements, and other
 25 financial information included in this report, fairly present in all material
 26 respects the financial condition, results of operations and cash flows of
 27 the registrant as of, and for, the periods presented in this report;
 28

1 4. The registrant's other certifying officer and I are responsible
2 for establishing and maintaining disclosure controls and procedures (as
3 defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal
4 control over financial reporting (as defined in Exchange Act Rules 13a-
5 15(f) and 15d-15(f)) for the registrant and have:

6 (a) Designed such disclosure controls and procedures, or
7 caused such disclosure controls and procedures to be designed under our
8 supervision, to ensure that material information relating to the registrant,
9 including its consolidated subsidiaries, is made known to us by others
10 within those entities, particularly during the period in which this report is
11 being prepared;

12 (b) Designed such internal control over financial
13 reporting, or caused such internal control over financial reporting to be
14 designed under our supervision, to provide reasonable assurance
15 regarding the reliability of financial reporting and the preparation of
16 financial statements for external purposes in accordance with generally
17 accepted accounting principles;

18 (c) Evaluated the effectiveness of the registrant's
19 disclosure controls and procedures and presented in this report our
20 conclusions about the effectiveness of the disclosure controls and
21 procedures, as of the end of the period covered by this report based on
22 such evaluation; and

23 (d) Disclosed in this report any change in the registrant's
24 internal control over financial reporting that occurred during the
25 registrant's most recent fiscal quarter (the registrant's fourth fiscal
26 quarter in the case of an annual report) that has materially affected, or is
27 reasonably likely to materially affect, the registrant's internal control
28 over financial reporting; and

1 5. The registrant's other certifying officer and I have
2 disclosed, based on our most recent evaluation of internal control over
3 financial reporting, to the registrant's auditors and the audit committee of
4 the registrant's board of directors (or persons performing the equivalent
5 functions):

6 (a) All significant deficiencies and material weaknesses
7 in the design or operation of internal control over financial reporting
8 which are reasonably likely to adversely affect the registrant's ability to
9 record, process, summarize and report financial information; and

10 (b) Any fraud, whether or not material, that involves
11 management or other employees who have a significant role in the
12 registrant's internal control over financial reporting.

13 38. On May 13, 2008, the Company issued a press release entitled "American
14 Apparel Reports First Quarter 2008 Financial Results." In the press release, the
15 Company announced:

16 Total retail sales across all segments increased 65% to
17 \$63.1 million for the first quarter of 2008 as compared to \$38.3 million
18 for the same period in 2007, with same-store sales for stores open at least
19 12 months rising 36%. . . .

20 Gross margin in the quarter declined 280 basis points to
21 55.3%. . . . The company also incurred additional training and startup
22 costs relating to increased hiring to support an expansion in production
23 capacity starting in the first quarter.

24 Operating expenses increased 170 basis points to 51.4% of sales,
25 partly as a result of a shift in mix due to the growth of the company's
26 retail operations. . . .

27
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1 Net income for the first quarter was \$1.1 million versus \$1.7
 2 million in the same period a year ago, or \$0.02 per diluted share versus
 3 \$0.03 per diluted share a year ago.

4 39. On May 16, 2008, the Company filed a Form 10-Q with the SEC. In the
 5 May 16, 2008 Form 10-Q, the Company reported its gross profits and operating
 6 expenses as follows:

7 **Gross Profit:** Gross profit percentage decreased from 58.1% of net
 8 sales for the three months ended March 31, 2007 to 55.3% of net sales
 9 for the three months ended March 31, 2008. One of the factors leading
 10 to the decrease in gross profit was the product sales mix for the three
 11 months ended March 31, 2008, which included a relatively higher
 12 amount of costlier winter styles. In addition, gross profit decreased as a
 13 result of the above described startup expenses, moving costs; increased
 14 hiring, freight and duty, and ERP cutover costs.

15 **OPERATING EXPENSES:** The following table sets forth American
 16 Apparel's operating expenses for the three months ended March 31,
 17 2008 as compared to the three months ended March 31, 2007 (dollars in
 18 thousands).

	<u>Three months ended</u> <u>March 31, 2008</u>		<u>Three months ended</u> <u>March 31, 2007</u>		<u>Change</u>	
	<u>Amount</u>	<u>% of</u> <u>operating</u> <u>expense</u>	<u>Amount</u>	<u>% of</u> <u>operating</u> <u>expense</u>	<u>Amount</u>	<u>%</u>
OPERATING EXPENSES	\$57,384	100%	\$36,498	100%	\$20,886	57.2%
Selling	36,782	64.1%	22,183	60.8%	14,599	65.8%
Warehouse and Distribution	3,167	5.5%	2,255	6.2%	912	40.4%
General and Administrative	17,435	30.4%	12,060	33.0%	5,375	44.6%
	\$57,384	100%	\$36,498	100%	\$20,886	

24 40. The May 16, 2008 Form 10-Q was signed by defendant Charney and
 25 CFO Cieply.
 26
 27
 28

1 41. On August 14, 2008, the Company issued a press release entitled
2 "American Apparel Reports Second Quarter 2008 Financial Results." In the press
3 release, the Company stated:

4 Gross margin for the second quarter of 2008 increased to 59.5%
5 from 56.5% for the prior year second quarter. The increase in gross
6 margin was primarily the result of an increase in the mix of sales coming
7 from retail sales and online consumer sales, which generate a higher
8 gross margin than wholesale sales. This benefit was partially offset by
9 the impact of hiring of approximately 1,400 new manufacturing
10 employees in the second quarter of 2008 to support increased production.
11 During the period, American Apparel began operating a fabric dyeing
12 and finishing facility in Garden Grove, California, which it purchased in
13 May. Gross margin for the U.S. Wholesale segment decreased to 28.4%
14 in the second quarter of 2008, versus 28.9% in the second quarter of
15 2007.

16 42. On August 15, 2008, the Company filed a Form 10-Q with the SEC. In
17 the August 15, 2008 Form 10-Q, the Company reported gross profits and operating
18 expenses as follows:

19 **Gross profit:** Gross profit percentage increased from 56.5% of net
20 sales for the three months ended June 30, 2007 to 59.5% of net sales for
21 the three months ended June 30, 2008. Gross margin benefited from an
22 increase in the mix of sales coming from retail sales versus wholesale,
23 along with an increase in online consumer sales. This benefit was
24 partially offset by the hiring of a significant number of new
25 manufacturing employees to support increased production which
26 continued through the second quarter.

27 **OPERATING EXPENSES:** The following table sets forth the
28 Company's operating expenses for the three months ended June 30, 2008

1 as compared to the three months ended June 30, 2007 (dollars in
2 thousands).

	Three Months Ended				Change	
	<u>June 30, 2008</u>		<u>June 30, 2007</u>		<u>Amount</u>	<u>%</u>
	<u>Amount</u>	<u>% of operating expenses</u>	<u>Amount</u>	<u>% of operating expenses</u>		
Selling	\$39,257	61.9%	\$28,307	67.4%	\$10,950	38.7%
Warehouse and Distribution	4,069	6.4%	1,998	4.8%	2,071	103.7%
General and Administrative	<u>20,116</u>	31.7%	<u>11,688</u>	27.8%	<u>8,428</u>	72.1%
Total operating expenses	\$63,442	100.0%	\$41,993	100.0%	\$21,449	51.1%

8 43. On October 29, 2008, the Company filed a proxy statement with the SEC.
9 The proxy statement included a Report of the Audit Committee, which discussed the
10 Audit Committee's role in ensuring the Company's compliance with legal regulatory
11 requirements:

12 The Audit Committee assists the Board in fulfilling its
13 responsibilities for general oversight of the integrity of the Company's
14 financial statements, the Company's compliance with legal and
15 regulatory requirements, the Company's system of internal control over
16 financial reporting and the qualifications, independence and performance
17 of the Company's internal audit function and independent auditor.

18 * * *

19 Based on the reviews and discussions referred to above, we
20 recommended to the Board of Directors, and the Board of Directors has
21 approved, that the audited financial statements be included in the
22 Company's Annual Report on Form 10-K for the fiscal year ended
23 December 31, 2007 for filing with the SEC.

24 44. On November 10, 2008, the Company filed a Form 10-Q with the SEC.
25 In the November 10, 2008 Form 10-Q, the Company reported its gross profits and
26 operating expenses as follows:

27 **Gross profit:** Gross profit percentage decreased from 55.2% of net
28 sales for the three months ended September 30, 2007 to 50.1% of net

1 sales for the three months ended September 30, 2008. Gross margin was
2 negatively impacted by the \$13.2 million of expenses from the stock
3 award to manufacturing employees and related employer payroll taxes.
4 The \$13.2 million of expenses decreased our gross margin by 8.5%.
5 Excluding the impact of the aforementioned expenses related to the stock
6 award, our gross margin increased from 55.2% for the three months
7 ended September 30, 2007 to 58.6% for the three months ended
8 September 30, 2008. The increase in our gross margin was due to an
9 increase in the mix of sales coming from retail sales versus wholesale
10 and an increase in online consumer sales. Gross profit was also
11 favorably impacted from a reduction in inventory reserves of
12 \$1.1 million which increased our gross profit percentage by 0.7% during
13 the three months ended September 30, 2008. The reduction in the
14 inventory reserve was primarily the result of the opening of two closeout
15 stores in key markets and expansion of certain existing closeout stores to
16 increase inventory for sale. Popular styles among the Company's slow-
17 moving stock were actively merchandized in these closeout stores,
18 resulting in higher inventory turnover of potentially obsolete inventory.
19 These benefits were partially offset by the hiring of additional
20 manufacturing employees, as described above, to support increased
21 production which continued through the third quarter ended September
22 30, 2008.

23 45. Also on November 10, 2008, the Company issued a press release entitled
24 "American Apparel Reports Third Quarter 2008 Financial Results." In the press
25 release, the Company stated:

26 American Apparel reported net sales for the quarter ended
27 September 30, 2008 of \$154.8 million, a 45.2% increase over net sales of
28 \$106.6 million for the quarter ended September 30, 2007.

* * *

1
2 Gross margin for the third quarter of 2008 was 50.1% versus
3 55.2% for the prior year third quarter, including the impact of the merger
4 related stock based compensation expense. . . .

5 Operating expenses for the third quarter of 2008 increased to
6 45.7% of net sales, versus 44.2% for the third quarter of 2007.
7 Operating expenses increased due to higher payroll, rent and occupancy
8 expense related to the growth in the number of retail stores from 163 as
9 of September 30, 2007 to 228 as of September 30, 2008. Pre-opening
10 expenses for retail stores were \$4.4 million in the third quarter of 2008,
11 versus \$0.9 million in the prior year third quarter. . . .

12 . . . Operating margin for the third quarter of 2008 was 4.4%,
13 versus 11.0% in the quarter a year ago.

14 46. On March 17, 2009, the Company issued a press release entitled
15 “American Apparel Reports Fourth Quarter and Full Year 2008 Financial Results.”
16 The press release stated:

17 Gross margin for the fourth quarter of 2008 was 55.4% versus
18 54.0% for the prior year fourth quarter. . . .

19 Operating expenses for the fourth quarter of 2008 decreased to
20 49.1% of net sales, versus 53.4% for the fourth quarter of 2007. Pre-
21 opening expenses for retail stores were \$3.6 million in the fourth quarter
22 of 2008, versus \$1.6 million in the prior year fourth quarter.

23 Operating income for the fourth quarter of 2008 was \$9.2 million,
24 versus \$0.6 million in the prior year fourth quarter. Operating margin for
25 the fourth quarter of 2008 was 6.3%, versus 0.6% in the fourth quarter
26 2007.

27 * * *

1 Net income for the fourth quarter of 2008 was \$3.9 million, or
2 \$0.05 per diluted share. Net income for the fourth quarter of 2007 was
3 \$3.0 million, or \$0.06 per diluted share.

4 * * *

5 Gross margin for the year ended December 31, 2008 was 54.9%
6 versus 55.7% for the year ended December 31, 2007, including the
7 impact of a \$13.2 million stock based compensation expense booked to
8 cost of sales in 2008 related to the grant of 1.9 million shares of stock to
9 manufacturing workers pursuant to the merger agreement between
10 Endeavor Acquisition Corp. and American Apparel, Inc. . . .

11 Operating expenses for the year ended December 31, 2008
12 increased to 48.3% of net sales, versus 47.6% for the year ended
13 December 31, 2007. Operating expenses increased due to higher payroll,
14 rent and occupancy expense related to the growth in the number of retail
15 stores from 182 as of December 31, 2007 to 260 as of December 31,
16 2008.

17 47. On March 16, 2009, the Company filed a Form 10-K with the SEC for
18 the year ended December 31, 2008. The 2008 Form 10-K was signed by defendants
19 Charney and Kowalewski and stated that “[t]he Company makes diligent efforts to
20 comply with all employment and labor regulations, including immigration laws, in
21 the many jurisdictions in which the Company conducts operations.”

22 48. In the 2008 Form 10-K, the Company reported its gross profits and
23 operating expenses as follows:

24 **Gross Profit:** Gross profit percentage decreased from 55.7% of net
25 sales for the year ended December 31, 2007 to 54.9% of net sales for the
26 year ended December 31, 2008. Gross margin was negatively impacted
27 by the \$13.2 million of expenses from the stock award to manufacturing
28 employees, including related employer payroll taxes. The \$13.2 million

1 of expenses decreased our gross margin by 2.4%. Excluding the impact
 2 of the aforementioned expenses related to the stock award, our gross
 3 margin for the year ended December 31, 2008 increased from 55.7% for
 4 the year ended December 31, 2007 to 57.3% for the year ended
 5 December 31, 2008. This increase in our gross margin was primarily
 6 due to an increase in the mix of sales coming from retail sales versus
 7 wholesale, along with an increase in online consumer sales. This benefit
 8 was partially offset by the hiring of a significant number of new
 9 manufacturing employees to support increased production.

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

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

17 49. On April 29, 2009, the Company filed a proxy statement with the SEC.
 18 The 2009 proxy statement included a Report of the Audit Committee, which discussed
 19 the Audit Committee's role in ensuring the Company's compliance with legal
 20 regulatory requirements:

21 The Audit Committee assists the Board in fulfilling its
 22 responsibilities for general oversight of the integrity of the Company's
 23 financial statements, the Company's compliance with legal and
 24 regulatory requirements, the Company's system of internal control over
 25 financial reporting and the qualifications, independence and performance
 26 of the Company's internal audit function and independent auditor.

27 * * *

1 by providing, on Form I-9, documentation which ICE believes, based on its
2 proprietary databases, to be suspect and not valid.”

3 52. The June 30, 2009 Form 8-K also falsely sought to reassure investors that
4 the Company did not believe that the loss of the employees in question would have a
5 material effect on its financial results, stating: “[E]ven if the Company were to lose
6 substantially all of the 1,800 identified employees (which represent approximately
7 one-third of the 5,600 employees the Company currently employs in its manufacturing
8 operations in the Los Angeles area), *the Company does not presently believe that the*
9 *loss of employees would have a materially adverse impact on its financial results.*”

10 53. On July 1, 2009, the Company issued a press release entitled “American
11 Apparel Announces Developments Regarding Inspection by U.S. Immigration and
12 Customs Enforcement.” The press release falsely reiterated that “[E]ven if the
13 Company were to lose substantially all of the employees identified by ICE (which
14 represent approximately one-third of the 5,600 employees the Company employs in its
15 manufacturing operations in the Los Angeles area), *the Company does not currently*
16 *believe that the loss of these employees would have a materially adverse impact on*
17 *its financial results.*”

18 54. Further, the July 1, 2009 press release stated falsely that, notwithstanding
19 the fact that a third of the Company’s workforce appeared to be ineligible to work in
20 the United States, the Company had a policy in place to verify the employment
21 eligibility of prospective employees:

22 It has been the Company’s policy to fully comply with its
23 obligations to establish the employment eligibility of prospective
24 employees under immigration laws, and the Company intends to
25 continue its cooperation with the ICE inspection in all respects. Howard
26 Shapiro, outside immigration counsel for American Apparel at Mitchell
27 Silberberg & Knupp, stated: “In early 2008, our review of the
28

1 Company's policies and procedures with respect to the immigration laws
2 found American Apparel to be in substantial compliance."

3 55. The press release also again falsely stated that the potential loss of the
4 identified employees would not have a material adverse effect on the Company's
5 operations, and suggested that such terminations might actually improve the
6 Company's bottom line, as they would only have to hire "for a fraction of those
7 employees that would be terminated":

8 The Company believes that its current surplus levels of inventory
9 and production capacity will mitigate the adverse impact of any
10 disruption to its manufacturing activities that may potentially result from
11 the loss of these employees. To the extent that the Company may need
12 to hire replacement workers, the Company presently believes it would
13 only need to hire for a fraction of those employees that would be
14 terminated.

15 56. Analysts who covered the Company took management at their word, and
16 reported that they did not expect that the loss of employees would materially affect the
17 Company's operations. On July 1, 2009, KeyBanc Capital Markets issued a report
18 entitled "APP: Immigration Issues Near-Term Distraction, Unfortunately Expected."
19 The report stated:

20 KEY INVESTMENT POINTS

21 *There's some paper, but thankfully no paddy wagons.* This
22 determination was met with a notice, and thankfully led to no mass arrest
23 or deportation of employees. In fact, the employees have a period of
24 remediation when they can demonstrate their eligibility to work.
25 *Management was clear in emphasizing that even if a significant*
26 *number of the 1,800 employees are deemed ineligible to work, the*
27 *Company should not see a material financial impact.*

28

1 57. Notwithstanding management's reassurances, between June 30 and
2 July 2, 2009, as partial revelations of the Company's prior and false statements and
3 omissions came to light, the Company's stock price fell \$0.60 a share, or almost 15%.

4 58. On August 13, 2009, the Company issued a press release entitled
5 "American Apparel Reports Second Quarter 2009 Financial Results." In the press
6 release, the Company stated:

7 Gross profit for the second quarter of 2009 was 59.0% versus 58.6% for
8 the prior year second quarter. . . .

9 Operating expenses for the second quarter of 2009 increased to
10 53.6% of net sales, versus 46.9% for the second quarter of 2008.

11 Operating expenses increased due to higher payroll, rent, occupancy, and
12 depreciation expenses related to the increase in the number of retail
13 stores in operation from 195 as of June 30, 2008 to 272 as of June 30,
14 2009. Pre-opening expenses for retail stores were \$0.9 million in the
15 second quarter of 2009, versus \$2.3 million in the prior year second
16 quarter.

17 Operating income for the second quarter of 2009 was \$7.3 million,
18 versus \$15.6 million in the prior year second quarter. Operating margin
19 for the second quarter of 2009 was 5.4%, versus 11.7% in the second
20 quarter of 2008.

21 59. Also on August 13, 2009, the Company filed a Form 10-Q with the SEC.
22 The Form 10-Q was signed by defendants Charney and Kowalewski. In the Form 10-
23 Q, the Company reported its gross profits and operating expenses as follows:

24 **GROSS PROFIT:** Gross profit increased from 54.6% of net sales
25 for the three months ended March 31, 2008 to 57.2% of net sales for the
26 three months ended March 31, 2009. The increase in gross profit was
27 primarily due to the change in sales mix for the three months ended
28 March 31, 2009, which included a higher percentage of sales through our

1 retail distribution channels, which generate higher gross profit, compared
 2 to sales generated through our third party wholesale customers. Due to
 3 the more rapid growth of our retail channels, the U.S. Wholesale
 4 segment represented only 24.5% of net sales in the three months ended
 5 March 31, 2009 compared to 33.5% of net sales in the three months
 6 ended March 31, 2008. The benefit of the shift in sales mix was partially
 7 offset by a decline in gross margin at the U.S. Wholesale segment. In
 8 the U.S. Wholesale segment, the gross profit decreased to 18.0% from
 9 18.6% as a result of lower capacity utilization of the Company's
 10 manufacturing facilities in light of lower wholesale demand and the
 11 Company's constrained liquidity position during the three months ended
 12 March 31, 2009 which necessitated lower than planned production
 13 volumes. Gross profit also decreased due to an increase in production of
 14 styles with more complex construction patterns, as well as unfavorable
 15 currency shifts as a result of the appreciation of the U.S. dollar in the
 16 International and Canadian business segments.

17 **OPERATING EXPENSES:** The following table sets forth our
 18 operating expenses for the three months ended March 31, 2009 as
 19 compared to the three months ended March 31, 2008:

	<u>Three months ended</u> <u>March 31, 2009</u>		<u>Three months ended</u> <u>March 31, 2008</u>		<u>Change</u>	
	<u>Amount</u>	<u>% of</u> <u>operating</u> <u>expense</u>	<u>Amount</u>	<u>% of</u> <u>operating</u> <u>expense</u>	<u>Amount</u>	<u>%</u>
Selling	\$41,443	59.8%	\$36,782	65.0%	\$4,661	12.7%
Warehouse and Distribution	3,900	5.6%	3,167	5.6%	733	23.1%
General and Administrative	<u>23,953</u>	34.6%	<u>16,665</u>	29.4%	<u>7,288</u>	43.7%
OPERATING EXPENSES	\$69,296	100%	\$56,614	100%	\$12,682	22.4%

25 60. In the August 13, 2009 Form 10-Q, the Company also falsely stated that
 26 "[i]t is the Company's policy, and has been at all times, to fully comply with its
 27 obligations to establish the employment eligibility of prospective employees under
 28

1 immigration laws, and the Company intends to continue its cooperation with the ICE
2 inspection in all respects.”

3 61. During a conference call on August 13, 2009, in which defendants
4 Kowalewski and Charney participated, Kowalewski once again sought to reassure
5 analysts that employees fired as a result of immigration issues would not negatively
6 impact the Company:

7 **Edward Yruma – KeyBanc Capital Markets – Analyst**

8 . . . Could you give us a quick update on the status of production,
9 particularly given some of the immigration issues that you suffered
10 from? Did you see any disruption? And what were the expenses in the
11 quarter associated with that?

12 [Kowalewski:] Well, given that we received an updated
13 communication from ICE towards the end of the quarter, this would have
14 had no financial impact on the second quarter.

15 **Edward Yruma – KeyBanc Capital Markets – Analyst**

16 Got you. But your guidance does embed some type of – I guess
17 maybe if you could just give an update on what impact you’ve seen, I
18 guess quarter to date.

19 [Kowalewski:] When we disclosed the ICE notice on July 1, we
20 indicated that at the time, despite the fact that it was difficult to estimate
21 what the impact would be on our results, we didn’t believe it would have
22 a material impact, given the fact that we had effectively hired significant
23 amounts of people at the end of Q2 ‘08.

24 And so, with the decline, also, we were in a situation where we
25 had more labor than was really justified by the amount of business or
26 unit volume that we were seeing. So by – if we were forced to reduce
27 our workforce, the way we would mitigate that would be by increasing
28 the days per week of our employees on the selling floor; so that would

1 virtually pick up all of the reduction in labor that we might see if we had
2 a loss in workers.

3 * * *

4 I think at this point, we don't have an update on what the financial
5 impact would be. I think we would basically just reiterate what we said
6 at the beginning of July, which is at this point difficult to estimate, *but*
7 *we do not believe that it's material.*

8 62. By this time, American Apparel's stock had dropped \$11.80 per share
9 from its Class Period high. However, it continued to be inflated by management's
10 assurances that any enforcement of immigration laws would not have a materially
11 adverse effect on the Company.

12 63. On September 11, 2009, the Company filed a proxy statement with the
13 SEC. The 2009 proxy statement included a Report of the Audit Committee, which
14 discussed the Audit Committee's role in ensuring the Company's compliance with
15 legal regulatory requirements:

16 The Audit Committee assists the Board in fulfilling its
17 responsibilities for general oversight of the integrity of the Company's
18 financial statements, the Company's compliance with legal and
19 regulatory requirements, the Company's system of internal control over
20 financial reporting and the qualifications, independence and performance
21 of the Company's internal audit function and independent auditor.

22 * * *

23 Based on the reviews and discussions referred to above, the Audit
24 Committee recommended to the Board of Directors that the audited
25 financial statements be included in the Company's Annual Report on
26 Form 10-K for the fiscal year ended December 31, 2008 for filing with
27 the SEC.

28

1 64. On November 10, 2009, the Company filed a Form 10-Q with the SEC.
2 The Form 10-Q was signed by defendants Charney and Kowalewski. In the Form 10-
3 Q, the Company reported its gross profits and operating expenses as follows:

4 **GROSS PROFIT:** Gross profit as a percentage of net sales
5 increased to 58.1% of net sales for the nine months ended September 30,
6 2009 from 53.8% of net sales for the nine months ended September 30,
7 2008, primarily as a result of the aforementioned shift in mix towards
8 retail sales, the share based compensation expense and related payroll tax
9 charges recorded in the third quarter of 2008 as well as due to effect of
10 unfavorable currency shifts caused by the appreciation of the U.S. dollar
11 against various foreign currencies in the current period versus the
12 comparable prior year period. Without giving effect to the stock award to
13 manufacturing employees, gross profit as a percentage of net sales for
14 the nine months ended September 30, 2008 would have been 57.1%.

15 **OPERATING EXPENSES:** The following table sets forth our
16 operating expenses for the nine months ended September 30, 2009 as
17 compared to the nine months ended September 30, 2008:

	Nine months ended September 30,		2008		Change	
	<u>2009</u>	<u>% of</u>	<u>2008</u>	<u>% of</u>	<u>Amount</u>	<u>%</u>
	<u>Amount</u>	<u>operating</u>	<u>Amount</u>	<u>operating</u>	<u>Amount</u>	<u>%</u>
		<u>expenses</u>		<u>expenses</u>		
18 Selling	\$134,861	61.8%	\$122,212	64.9%	\$12,649	10.4%
19 Warehouse and Distribution	12,155	5.6%	11,559	6.2%	596	5.2%
20 General and Administrative	<u>71,261</u>	32.6%	<u>54,405</u>	28.9%	<u>16,856</u>	31.0%
21 OPERATING EXPENSES	<u>\$218,277</u>	100.0%	<u>\$188,176</u>	100.0%	<u>\$30,101</u>	16%

22 65. The November 10, 2009 Form 10-Q also stated that the Company had
23 fired all employees whose immigration status could not be verified, and that the
24 Company had been fined by ICE:
25

26 The Company has terminated the employment of those persons
27 identified by ICE who were not able to resolve the discrepancies in their
28 work records, or present valid identification and employment eligibility

1 documents. In the fourth quarter of 2009, as a result of the inspection,
2 the Company was fined by ICE for an amount that was deemed
3 immaterial, and the amount was accrued in the accompanying condensed
4 consolidated balance sheet as of September 30, 2009.

5 It is the Company's policy, and has been at all times, to fully
6 comply with its obligations to establish the employment eligibility of
7 prospective employees under immigration laws.

8 66. Also on November 10, 2009, the Company issued a press release entitled
9 "American Apparel Reports Third Quarter 2009 Financial Results." In the press
10 release, the Company stated:

11 Gross margin for the third quarter of 2009 was 58.1% as compared
12 to 49.1% for the prior year third quarter. The gross margin in the third
13 quarter of 2008 was negatively impacted by \$13.2 million in share based
14 compensation expense relating to the award of approximately 1.9 million
15 shares of stock to manufacturing employees during the third quarter of
16 2008, granted pursuant to the 2007 merger between American Apparel,
17 Inc. (formerly Endeavor Acquisition Corp.) and American Apparel, Inc.,
18 a California corporation ("Old American Apparel"). . . .

19 Operating expenses, including selling, warehouse and distribution,
20 and general and administrative expenses, increased to 50.6% of net sales
21 for the third quarter of 2009, compared to 44.7% for the third quarter of
22 2008. Operating expenses increased due to higher payroll, rent,
23 occupancy, and depreciation expenses related to the greater number of
24 retail stores in operation in the period versus the same period last year. . .

25 Operating income for the third quarter of 2009 was \$11.2 million.
26 This compares to \$6.8 million in the third quarter of 2008, which
27 included the merger related share based compensation expense of \$13.2
28

1 million. Operating margin for the third quarter of 2009 was 7.5% versus
2 4.4% for the third quarter of 2008.

3 67. Also on November 10, 2009, the Company held a conference call in
4 which defendants Kowalewski and Charney participated. During the conference call,
5 defendants in part revealed the problems the Company was having as a result of its
6 practice of hiring workers who were ineligible for employment in the U.S., but
7 continued to reassure investors that the departures would not materially affect
8 operations:

9 [Kowalewski:] Finally, in the third quarter, we had to deal with
10 the difficult task of letting go approximately 1,500 manufacturing
11 workers who were identified by US Immigration and Customs
12 Enforcement as having provided the Company with suspect documents
13 in order to gain employment. Many of these workers had worked for the
14 Company for as long as 10 years and had been some of our best
15 employees.

16 * * *

17 **Edward Yruma – KeyBanc Capital Markets Inc. – Analyst**

18 Great. And my final question, can you help us quantify the impact
19 of the 1,500 departures in your manufacturing facility, how is the
20 performance in the existing facility now in your workers, and have you
21 been able to replace the ones that you have lost? Thank you.

22 [Kowalewski:] I think what we said back in July when we had
23 this issue was we didn't think it was going to have a material impact to
24 our financial results. And one of the reasons was because we had been
25 operating with a higher number of workers than maybe we would have
26 needed under normal circumstances. So we do think some of the head
27 count has improved our overhead situation, because we have more
28 workers working shorter work weeks and working more hours per week;

1 but as I mentioned in my remarks, a lot of the workers that we lost were
2 some of our most efficient people. If you look at it on a year over year
3 basis versus where we were last year when we were hiring a lot of
4 people, there was a lot of training cost that the Company bore, so *I think*
5 *on a year over year basis the efficiency in labor is probably pretty*
6 *comparable.*

7 * * *

8 [Charney:] We appreciate also a lot of the efforts that are being
9 made at the factory level. Marty has done a terrific job in the transition
10 we went through in the last couple of months, virtually seamless based
11 on losing the amount of workers we lost and the amount of workers we
12 had coming in.

13 68. On March 25, 2010, the Company issued a press release entitled
14 "American Apparel Reports Fourth Quarter and Full Year 2009 Financial Results." In
15 the press release, the Company reported:

16 Gross margin for the fourth quarter of 2009 was 55.0% as
17 compared to 54.5% for the prior year fourth quarter. Gross margin was
18 favorably impacted by the depreciation of the U.S. dollar against foreign
19 currencies in the fourth quarter of 2009 compared to the fourth quarter of
20 2008, and by a continuing shift in mix from wholesale to retail sales,
21 which generate higher gross margins. *These factors were largely offset*
22 *by a substantial reduction in manufacturing efficiency at the*
23 *company's production facilities in the fourth quarter of 2009 compared*
24 *to the prior year period. The reduction in manufacturing efficiency*
25 *was principally a result of the forced termination of over 1,500*
26 *experienced manufacturing employees in the third and fourth quarters*
27 *of 2009 following the completion of the previously disclosed I-9*
28 *inspection by U.S. Immigration and Customs Enforcement.*

* * *

1
2 Gross margin for 2009 was 57.3% as compared to 54.0% in 2008.
3 The gross margin for 2008 was negatively impacted by \$13.2 million in
4 stock based compensation expense relating to the award of
5 approximately 1.9 million shares of stock to manufacturing employees
6 during the third quarter of 2008, granted pursuant to the 2007 merger
7 between American Apparel, Inc. (formerly Endeavor Acquisition Corp.)
8 and American Apparel Inc., a California corporation (“Old American
9 Apparel”). The net impact of the stock based compensation expense was
10 to negatively impact gross margin in 2008 by approximately 240 basis
11 points. Gross margin for 2009 was favorably impacted by a shift in mix
12 from wholesale to retail sales, as retail increased from 62.6% of total net
13 sales in 2008 to 67.9% of total net sales in 2009. The favorable impact
14 from the shift in mix was partially offset by the negative impact of the
15 appreciation of the U.S. dollar versus foreign currencies for the full year
16 2009 relative to the full year 2008. *Additionally, gross margin was also*
17 *negatively impacted by lower capacity utilization of the company’s*
18 *manufacturing facilities in the first half of 2009, and the substantial*
19 *reduction in manufacturing efficiency experienced in the fourth*
20 *quarter of 2009 at the company’s production facilities.*

21 Operating expenses for 2009 were \$295.5 million, or 52.9% of net
22 sales, as compared to \$258.4 million, or 47.4% for 2008. The increase in
23 operating expenses was primarily caused by increased occupancy,
24 payroll, and depreciation expenses incurred as a result of operating an
25 additional 21 net stores at the end of 2009 compared to the end of 2008,
26 as well as due to the full year impact of increased operating expenses
27 from the additional 78 net stores opened in 2008.

28

1 69. The March 25, 2010 press release also stated that because of its practice
2 of hiring workers who were ineligible for employment in the U.S., the Company was
3 unable to provide annual financial guidance:

4 Based on the substantial impact of the reduced manufacturing
5 efficiency experienced at the company's production facilities beginning
6 in the fourth quarter of 2009, and the high level of uncertainty
7 surrounding the duration of the reduction in efficiency, as well as due to
8 uncertainty stemming from the company's constrained ability to
9 undertake additional investments in its business as a result of certain
10 restrictive financial covenants under the company's credit facilities, the
11 company has determined to defer providing annual financial guidance
12 for 2010 until it reports its first quarter 2010 financial results in early
13 May.

14 70. Also on March 25, 2010, the Company held a conference call in which
15 defendants Kowalewski and Charney participated. During the conference call,
16 Kowalewski detailed the problems the Company was having due to its previously
17 undisclosed hiring practices:

18 [Kowalewski:] Aside from the global recessionary environment,
19 we faced a number of Company specific challenges in 2009 including
20 the refinancing extension of our credit facilities in March, a sharp decline
21 in wholesale sales in Q1 which led to lower capacity utilization of our
22 production facilities, significant declines in same-store sales that were
23 exacerbated due to cannibalization following the accelerated store rollout
24 in 2008 *and perhaps most significantly, the dismissal of over 1,500*
25 *experienced manufacturing employees in Q3 and Q4 in the wake of the*
26 *previously disclosed I-9 inspection by US Immigration and Customs*
27 *enforcement as well as the impact this has had on our manufacturing*
28 *efficiency.*

* * *

1
2 Turning to gross profit, for the fourth quarter gross margin
3 increased 50 basis points to 55% of net sales as compared to 54.5% in
4 the fourth quarter of 2008. Despite a favorable currency swings [sic] and
5 the continued shift in mix towards retail sales, *these factors were largely*
6 *offset by a significant reduction in production efficiency in the fourth*
7 *quarter of '09 due to the dismissals in Q3 and Q4 following the results*
8 *of the I9 inspection. While the increase in manufacturing costs*
9 *impacted Q4, it was also expected to impact our gross margins going*
10 *forward especially to the extent that the Company is not able to quickly*
11 *return to its previous levels of manufacturing efficiency.* While our
12 production team has worked ceaselessly to transition our manufacturing
13 plants in the face of such unprecedented disruption and will continue to
14 work to bring efficiency levels back to where they were prior to the
15 layoff, there is considerable uncertainty about the length of the period of
16 lower efficiency.

17 71. Following these announcements, which partially revealed the truth
18 regarding the Company's financial condition, on March 26, 2010, the Company's
19 stock price dropped \$0.67 on trading of over 1.8 million shares.

20 72. On March 31, 2010, the Company filed a Form 10-K with the SEC. The
21 Form 10-K was signed by defendants Charney and Kowalewski. In the Form 10-K,
22 defendants detailed the serious impact of the Company's practice of hiring workers
23 who were ineligible for employment in the U.S.:

24 **Cost of sales:** Cost of sales as a percentage of net sales was 42.7%
25 and 46.0% for the years ended December 31, 2009 and 2008,
26 respectively. . . . The favorable impact from the shift in mix was
27 partially offset by the negative impact of the appreciation of the U.S.
28 dollar versus foreign currencies for the full year 2009 relative to the full

1 year 2008. Additionally, cost of sales was also negatively impacted by
2 lower capacity utilization of our manufacturing facilities in the first half
3 of 2009, and the *substantial reduction in manufacturing efficiency*
4 *experienced in the fourth quarter of 2009 at our production facilities.*

5 **Gross profit:** Gross margin for 2009 was 57.3% as compared to
6 54.0%, or 56.4% excluding the impact of the 2008 Grant, in 2008. The
7 increase in gross margin was due to a favorable shift in mix from
8 wholesale towards retail sales, as retail sales generate a higher gross
9 margin. *This increase was partially offset due to an increase in*
10 *inventory costs caused by a reduction in labor efficiency in the second*
11 *half of 2009* and a continued shift in production mix towards more
12 complex retail styles. *We expect that the effects of lower production*
13 *efficiency will continue into 2010.*

14 * * *

15 **Operating expenses:** Operating expenses increased \$37.1 million,
16 or 14.4%, to \$295.5 million for the year ended December 31, 2009 as
17 compared to \$258.4 million for the year ended December 31, 2008. The
18 increase in operating expenses was primarily caused by increased
19 occupancy, payroll, and depreciation expenses incurred as a result of
20 operating an additional 21 net stores at the end of 2009 compared to the
21 end of 2008, as well as due to the full year impact of increased operating
22 expenses from the additional 78 net new stores opened in 2008.
23 Operating expenses were also higher in 2009 due to \$3.3 million in non-
24 cash retail store impairment charges recorded in 2009 compared to \$0.6
25 million in 2008. Pre-opening expenses for retail stores were \$2.4 million
26 in 2009 versus \$10.3 million in 2008.

27 73. On May 11, 2010, the Company filed a Form NT 10-Q with the SEC
28 announcing that it was unable to timely file its Form 10-Q. The Form NT 10-Q was

1 signed by defendant Kowalewski. The Form NT 10-Q reported the Company's
2 continuing poor performance as a result its practice of hiring workers who were
3 ineligible for employment in the U.S.:

4 Net sales are expected to increase for the quarter ended March 31,
5 2010 compared to the quarter ended March 31, 2009, primarily as a
6 result of an increase in net sales to the Company's wholesale customers,
7 and also a result, although to a lesser extent, of an increase in net sales in
8 the Company's retail business. The increase in retail sales was due to a
9 larger number of retail store locations in operation in the first quarter of
10 2010 as compared to the first quarter of 2009. The Company operated
11 280 retail store locations as of March 31, 2010, as compared to 264 retail
12 store locations as of March 31, 2009. The increase in retail net sales was
13 partially offset by negative comparable retail store sales in the first
14 quarter of 2010. *The Company expects to report a larger net loss in the*
15 *first quarter of 2010 as compared to the first quarter of 2009, primarily*
16 *as a result of higher cost of sales due to increased manufacturing*
17 *costs, and higher operating expenses related to the higher number of*
18 *retail stores in operation in the first quarter of 2010 compared to the first*
19 *quarter of 2009.*

20 It is expected that gross margin will decrease for the quarter ended
21 March 31, 2010 compared to the quarter ended March 31, 2009,
22 primarily due to a change in the overall sales mix to a higher level of
23 wholesale net sales which generate lower gross margins than the
24 Company's retail net sales, and *due to increased manufacturing costs.*
25 Additionally, compensation expense related to a stock grant to the
26 Company's manufacturing employees in the first quarter of 2010 was
27 also recorded in cost of sales for the quarter.

28 74. On May 18, 2010, American Apparel's stock closed at \$2.74 per share.

1 75. On May 19, 2010, the Company issued a press release entitled “American
2 Apparel Reports Preliminary First Quarter 2010 Financial Results.” In the press
3 release, the Company disclosed the continuing fallout from its immigration violations:

4 American Apparel reported net sales for the first quarter ended
5 March 31, 2010 of \$121.8 million, a 6.6% increase over net sales of
6 \$114.3 million for the first quarter ended March 31, 2009. Total retail
7 net sales increased 1.5% to \$79.1 million for the first quarter of 2010 as
8 compared to \$78.0 million for the same period in 2009, with comparable
9 store sales for stores open at least 12 months declining 10% on a
10 constant currency basis. American Apparel ended the quarter with 280
11 retail stores, having closed two retail stores and opened one during the
12 first quarter of 2010, as compared to 264 retail stores at the end of the
13 first quarter of 2009. Total wholesale net sales increased 21.6% to \$34.2
14 million for the first quarter of 2010 compared to \$28.1 million for the
15 first quarter of 2009, largely due to an increase in sales to distributor
16 customers. Online consumer sales increased 3.6% to \$8.4 million for the
17 first quarter of 2010 compared to \$8.2 million for the first quarter of
18 2009.

19 Gross margin for the first quarter of 2010 was 50.4% as compared
20 to 57.2% for the prior year first quarter. Gross margin was negatively
21 impacted by a shift in mix from retail to wholesale net sales, which
22 generate lower margins, *and by reduced labor efficiency at the*
23 *company’s production facilities in the first quarter of 2010 compared*
24 *to the prior year period. The reduction in labor efficiency was a result*
25 *of the dismissal of over 1,500 experienced manufacturing employees in*
26 *the third and fourth quarters of 2009 following the completion of an I-*
27 *9 inspection by U.S. Immigration and Customs Enforcement, as well as*
28 the impact of an increase in the mix of more complex retail styles

1 produced. The unfavorable decline in gross margin was partially offset
2 by the effect of the depreciation of the U.S. dollar versus foreign
3 currencies in the first quarter of 2010 as compared to the first quarter of
4 2009.

5 * * *

6 *For the first quarter of 2010, the impact of lower manufacturing*
7 *efficiency is estimated to have reduced operating income by*
8 *approximately \$4.4 million. The company currently expects that the*
9 *reduced manufacturing efficiency at the company's production*
10 *facilities beginning during the fourth quarter of 2009 could likely*
11 *continue through the end of 2010, and could impact the company's*
12 *financial results at least through early 2011. The company*
13 *experienced an improvement in production efficiency in the first*
14 *quarter of 2010 versus the fourth quarter of 2009, but anticipates a*
15 *temporary worsening in efficiency during the second quarter of 2010*
16 *as additional manufacturing workers will need to be hired and trained*
17 *to meet a seasonal increased demand for the company's products. The*
18 *duration and ultimate financial impact of the inefficiencies is difficult*
19 *to estimate, and the financial impact in future quarters could differ*
20 *significantly from the level experienced during the first quarter of*
21 *2010.*

22 76. Also on May 19, 2010, the Company held a conference call with analysts
23 in which defendants Kowalewski and Charney participated. During the conference
24 call, defendants partially revealed the truth regarding the Company's financial
25 condition:

26 [Kowalewski:] Our gross margins continue to face pressure due to
27 lower production efficiency probably associated with the dismissal of
28 1,500 manufacturing employees following the I-9 inspection by US

1 Immigration and Customs Enforcement in 2009. Dov, along with Marty
2 Bailey our President of Manufacturing and Chief Manufacturing Officer,
3 continue to work to train our new employees and increase efficiency and
4 lead us back to our historical gross margin.

5 While improvements in our production efficiency were
6 experienced in the first quarter, we believe it will take at least several
7 quarters to return to prior levels of efficiency and the impact on our
8 reported gross margins may continue into the early part of 2011 as we
9 continue to sell-through goods that have this higher cost of labor
10 associated with them.

11 * * *

12 Turning to gross profit, for the first quarter gross margin decreased
13 680 basis points to 50.4% of net sales compared to 57.2% in the first
14 quarter of 2009. Despite favorable currency shifts on a year-over-year
15 basis, particularly with respect to the Canadian dollar, our gross margin
16 was negatively impacted by a shift in mix from retail to wholesale net
17 sales and by *reduced labor efficiency at our production facilities. Our*
18 *estimate of the P&L impact [of] abnormal labor variances for the first*
19 *quarter of 2010 was approximately \$4.4 million.*

20 77. Following these announcements, which partially revealed the truth
21 regarding the Company's financial condition, on May 19, 2010, the Company's stock
22 price dropped \$1.11 per share to close at \$1.63 per share, on trading of over
23 2.8 million shares.

24 78. On July 28, 2010, the Company filed a Form 8-K with the SEC. The
25 Form 8-K announced that Deloitte and Touche, LLP, the Company's independent
26 registered public accountant, had resigned effective July 22, 2010. The Form 8-K
27 further stated that "Deloitte advised the Company that certain information has come to
28 Deloitte's attention, that if further investigated may materially impact the reliability of

1 either its previously issued audit report or the underlying consolidated financial
2 statements for the year ended December 31, 2009 included in the Company's 2009
3 Form 10-K."

4 79. On August 17, 2010, the Company issued a press release entitled
5 "American Apparel Reports Preliminary Second Quarter 2010 Financial Results."
6 The press release reported that the Company expected to report a loss of \$5 million to
7 \$7 million in the second quarter of 2010 on net sales of \$132 million to \$143 million.
8 A significant factor in such losses was "lower labor efficiency at the Company's
9 production facilities in the second quarter of 2010 compared to the prior year period.
10 The lower labor efficiency was primarily a result of the hiring of over 1,600 net new
11 manufacturing workers during the second quarter of 2010." The press release
12 continued:

13 Gross margin for the second quarter of 2010 is expected to be in
14 the range of 50% to 52%, as compared to 59.0% for the prior year
15 second quarter. Gross margin was negatively impacted by a shift in mix
16 from retail to wholesale net sales, which generate lower margins, and by
17 *lower labor efficiency at the Company's production facilities in the*
18 *second quarter of 2010 compared to the prior year period. The lower*
19 *labor efficiency was primarily a result of the hiring of over 1,600 net*
20 *new manufacturing workers during the second quarter of 2010*, as well
21 as the impact of an increase in the mix of more complex retail styles
22 produced.

23 Loss from operations for the second quarter of 2010 is expected to
24 be in the range of \$5 million to \$7 million, as compared to income from
25 operations of \$7.3 million in the second quarter of 2009.

26 80. The August 17, 2010, press release also stated that as results of the
27 Company's poor performance, its very existence was now in doubt:
28

1 defraud and committed acts, practices and participated in a course of business that
2 operated as a fraud or deceit on purchasers of American Apparel common stock
3 during the Class Period.

4 **LOSS CAUSATION/ECONOMIC LOSS**

5 85. During the Class Period, as detailed herein, defendants made false and
6 misleading statements and engaged in a scheme to deceive the market. This
7 artificially inflated American Apparel's stock price and operated as a fraud or deceit
8 on the Class. Later, when defendants' prior misrepresentations and fraudulent
9 conduct began to be revealed to the market, American Apparel's stock price fell
10 precipitously, as the prior artificial inflation came out of the stock price over time. As
11 a result of their purchases of American Apparel common stock during the Class
12 Period, plaintiff and other members of the Class suffered economic loss, *i.e.*, damages,
13 under the federal securities laws.

14 **APPLICABILITY OF PRESUMPTION OF RELIANCE:
15 FRAUD ON THE MARKET**

16 86. Plaintiff will rely upon the presumption of reliance established by the
17 fraud-on-the-market doctrine in that, among other things:

- 18 (a) Defendants made public misrepresentations or failed to disclose
19 material facts during the Class Period;
- 20 (b) The omissions and misrepresentations were material;
- 21 (c) The Company's stock traded in an efficient market;
- 22 (d) The misrepresentations alleged would tend to induce a reasonable
23 investor to misjudge the value of the Company's stock; and
- 24 (e) Plaintiff and other members of the Class purchased American
25 Apparel common stock between the time defendants misrepresented or failed to
26 disclose material facts and the time the true facts were disclosed without knowledge of
27 the misrepresented or omitted facts.
- 28

1 87. At all relevant times, the market for American Apparel common stock
2 was efficient for the following reasons, among others:

3 (a) As a regulated issuer, American Apparel filed periodic public
4 reports with the SEC; and

5 (b) American Apparel regularly communicated with public investors
6 via established market communication mechanisms, including through regular
7 disseminations of press releases on the major news wire services and through other
8 wide-ranging public disclosures, such as communications with the financial press,
9 securities analysts and other similar reporting services.

10 **CLASS ACTION ALLEGATIONS**

11 88. Plaintiff brings this action as a class action pursuant to Rule 23 of the
12 Federal Rules of Civil Procedure on behalf of all persons who purchased American
13 Apparel common stock during the Class Period (the "Class"). Excluded from the
14 Class are defendants and members of their families, directors and officers of
15 American Apparel and their families and affiliates.

16 89. The members of the Class are so numerous that joinder of all members is
17 impracticable. The disposition of their claims in a class action will provide substantial
18 benefits to the parties and the Court. American Apparel had more than 71 million
19 shares of stock outstanding, owned by thousands of persons.

20 90. There is a well-defined community of interest in the questions of law and
21 fact involved in this case. Questions of law and fact common to the members of the
22 Class, which predominate over questions which may affect individual Class members,
23 include:

24 (a) Whether the 1934 Act was violated by defendants;
25 (b) Whether defendants omitted and/or misrepresented material facts;
26 (c) Whether defendants' statements omitted material facts necessary in
27 order to make the statements made, in light of the circumstances under which they
28 were made, not misleading;

1 (d) Whether defendants knew or recklessly disregarded that their
2 statements were false and misleading;

3 (e) Whether the price of American Apparel common stock was
4 artificially inflated; and

5 (f) The extent of damage sustained by Class members and the
6 appropriate measure of damages.

7 91. Plaintiff's claims are typical of those of the Class because plaintiff and
8 the Class sustained damages from defendants' wrongful conduct.

9 92. Plaintiff will adequately protect the interests of the Class and has retained
10 counsel who are experienced in class action securities litigation. Plaintiff has no
11 interests which conflict with those of the Class.

12 93. A class action is superior to other available methods for the fair and
13 efficient adjudication of this controversy.

14 **NO SAFE HARBOR**

15 94. American Apparel's verbal "Safe Harbor" warnings accompanying its
16 oral forward-looking statements ("FLS") issued during the Class Period were
17 ineffective to shield those statements from liability.

18 95. The defendants are also liable for any false or misleading FLS pleaded
19 because, at the time each FLS was made, the speaker knew the FLS was false or
20 misleading and the FLS was authorized and/or approved by an executive officer of
21 American Apparel who knew that the FLS was false. None of the historic or present
22 tense statements made by defendants were assumptions underlying or relating to any
23 plan, projection or statement of future economic performance, as they were not stated
24 to be such assumptions underlying or relating to any projection or statement of future
25 economic performance when made, nor were any of the projections or forecasts made
26 by defendants expressly related to or stated to be dependent on those historic or
27 present tense statements when made.

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COUNT I

**For Violations of Section 10(b) of the 1934 Act
and Rule 10b-5 Against All Defendants**

96. Plaintiff incorporates ¶¶1-95 by reference.

97. During the Class Period, defendants disseminated or approved the false statements specified above, which they knew or recklessly disregarded were misleading in that they contained misrepresentations and failed to disclose material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

98. Defendants violated §10(b) of the 1934 Act and Rule 10b-5 in that they:

(a) Employed devices, schemes, and artifices to defraud;

(b) Made untrue statements of material facts or omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or

(c) Engaged in acts, practices, and a course of business that operated as a fraud or deceit upon plaintiff and others similarly situated in connection with their purchases of American Apparel common stock during the Class Period.

99. Plaintiff and the Class have suffered damages in that, in reliance on the integrity of the market, they paid artificially inflated prices for American Apparel common stock. Plaintiff and the Class would not have purchased American Apparel common stock at the prices they paid, or at all, if they had been aware that the market prices had been artificially and falsely inflated by defendants' misleading statements.

100. As a direct and proximate result of these defendants' wrongful conduct, plaintiff and the other members of the Class suffered damages in connection with their purchases of American Apparel common stock during the Class Period.

COUNT II

**For Violation of Section 20(a) of the 1934 Act
Against All Defendants**

101. Plaintiff incorporates ¶¶1-100 by reference.

