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CANADA  
PROVINCE OF QUEBEC  
DISTRICT OF QUEBEC  
DIVISION: 01-MONTREAL  
S.C.: 500-11-051625-164  
500-11-051624-167

SUPERIOR COURT  
(Commercial Division)

**IN THE MATTERS OF THE NOTICES  
OF INTENTION AND OF THE  
INTERIM RECEIVERSHIP OF:**

**AMERICAN APPAREL CANADA RETAIL INC.**, a corporation duly incorporated under the *Canada Business Corporations Act* (Canada) and continued under the *Business Corporations Act* (Quebec), having its head office at 1550 rue Metcalfe, Suite 1500, Montreal, QC, H3A 1X6

- and -

**AMERICAN APPAREL CANADA WHOLESALE INC.**, a corporation duly incorporated under the *Canada Business Corporations Act* (Canada) and continued under the *Business Corporations Act* (Quebec), having its head office at 1550 rue Metcalfe, Suite 1500, Montreal, QC, H3A 1X6

*Debtors*

- and -

**KPMG INC.**, a corporation duly incorporated under the *Canada Business Corporations Act* (Canada), having a place of business at 600, boul. De Maisonneuve Blvd. West, Suite 1500 Montreal, QC, H3A 0A3

*Trustee/Interim Receiver*

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**Report of the Trustee pursuant to section 50.4(7) of the Bankruptcy and Insolvency Act (“BIA”) and Report of the Interim Receiver pursuant to section 47.1(2) of the BIA on his administration to date (“First Report of the Trustee and the Interim Receiver”).**

I, Dev A. Coossa, CIRP, LIT, of KPMG Inc., in my capacity as Trustee under the Notices of Intention filed in respect of each of the Debtors and as Interim Receiver of the Debtors, report to this honorable Court as follows.

## INTRODUCTION

1. American Apparel Canada Retail Inc. (“**AA Retail**”) and American Apparel Canada Wholesale Inc. (“**AA Wholesale**”, and, together with AA Retail, the “**Company**” or “**American Apparel**”), each filed on November 9, 2016, a Notice of Intention to make a Proposal (“**NOI**”) under the provisions of the BIA, and KPMG Inc. was named as Trustee to the NOI (in such capacity, the “**Trustee**”). The initial stay of proceedings triggered by the filing of the NOI is expiring on December 9, 2016.
2. On November 11, 2016, the Debtors filed a Motion for the Appointment of an Interim Receiver of the Debtors’ assets (the “**I/R Motion**”), by which the appointment of KPMG Inc. as interim receiver was sought, the whole pursuant to section 47.1 of the BIA. On the same date, an appointment order (“**Order**”) was issued by the Court naming KPMG Inc. as Interim Receiver to the Debtors’ assets (in such capacity, the “**Interim Receiver**”).
3. The appointment of the Interim Receiver by the Court was deemed necessary by the fact that, *inter alia*, American Apparel’s US parent (“**American Apparel US**”), recently ceased providing important administrative support to American Apparel. The absence of such support functions made American Apparel unable to successfully undertake its proceedings under the BIA and consequently, the Interim Receiver was appointed to assume the majority of those functions and support the Company in said proceedings. Reference is made for the purposes hereof to the I/R Motion (Appendix A) for additional background on the appointment of the Interim Receiver.
4. On December 6, 2016, the Company filed a motion (“**Motion**”) seeking an order extending the initial deadline for the filing of a proposal until January 23, 2017 (the “**First Extension Period**”).
5. Reference is made to the Motion for additional background and other information on the Company and its proceedings.
6. The purpose of this First Report of the Trustee and the Interim Receiver is to provide the Court with information on the following:
  - a) The Company’s activities since the date of the filing of the NOI;
  - b) The Interim Receiver’s actions following the NOI;
  - c) The Company’s inventory monetisation process;
  - d) The Company’s actual cash flows between November 9 and December 3, 2016, compared to the projected amounts;
  - e) The Company’s projected cash flows for the period commencing December 4, 2016 until January 28, 2017;
  - f) The reasons for which the Trustee/Interim Receiver supports the relief sought by the Company in the context of the Motion;
  - g) The recommendations of the Trustee/ Interim Receiver.
7. Since KPMG Inc.’s appointment, its responsibilities and activities as Trustee and as Interim Receiver, respectively, have been comingled and therefore, for the purpose of this report and to facilitate the reading thereof, we refer jointly to the Trustee and the Interim Receiver as the Interim Receiver.

## **THE DEBTORS' ACTIVITIES IMMEDIATELY PRECEDING AND SINCE THE DATE OF FILING OF THE NOI.**

### ***American Apparel US***

8. On or about November 8, 2016, American Apparel US, advised the Company that it would cease providing it with all stock and inventory. Historically, American Apparel US was the Company's sole product supplier and also owns the related intellectual property (trade name and trade marks). In addition, American Apparel performed certain corporate and administrative functions for American Apparel.
9. Prior to the NOI filing, American Apparel US sent the Company a notice cancelling the license allowing the usage of the trade marks in Canada. However, American Apparel U.S. advised in writing that it would take no action against the Company if it continued using the trade marks to dispose of the inventory on hand for a period of 90 days.
10. On November 14, 2016, American Apparel US filed for protection under Chapter 11 of Title 11 of the United States Bankruptcy Code ("**Chapter 11 Proceedings**"), and implemented a sales process for all of its operations and assets ("**Sale Process**").
11. Montreal based Gildan Activeware SRL is the stalking horse bidder in the Sale Process, with a stated intention of purchasing American Apparel US' intellectual property and inventory. The deadline for interested parties to submit bids is January 6, 2017 with an auction anticipated on January 9, 2017 and a sale hearing to be held January 12, 2017.
12. At this time, it is not determined whether or not the Sale Process will generate any interest for the Company's assets and/or operations (in Canada). Given that AA Retail is a creditor of American Apparel US, it is deemed to be in the interests of the Company's creditors to attempt to maximize, as much as possible, the realization value of the assets of American Apparel US in the context of the Sale Process and the Chapter 11 Proceedings.

### ***Canadian operations***

13. At the time of filing the NOI, AA Retail operated 28 stores in Canada, located in the provinces of Nova Scotia, Quebec, Ontario, Manitoba, Saskatchewan, Alberta and British Columbia. All the stores are located in leased premises with leases having terms varying from month to month, to several years.
14. American Apparel's activities following the filing of the NOI are constrained by the fact that they no longer are in a position to procure new merchandise; the stores effectively operating with whatever inventory was on hand at the time of the filing of the NOI. Notwithstanding this limitation, the Interim Receiver and American Apparel have determined that the Company must nonetheless try to preserve the "normalcy" of its operations for the duration of the Sale Process, in the event that some or all of the Canadian operations become part of a bid involving an overall international transaction.
15. On November 10, 2016, the Interim Receiver set-up a bilingual "hotline" as well as a dedicated email account address to address any queries from the Company's stakeholders, namely its employees, customers, landlords and creditors.
16. On November 14, 2016, the Interim Receiver sent a notice of the filing of the NOI, including certain prescribed documents, by regular mail, to all of the Company's known creditors, in accordance with the requirements of the BIA.

17. Since the filing of the NOI, American Apparel has continued to operate its stores under the supervision of the Interim Receiver, and with the assistance of the Interim Receiver's agent, Merchant Retail Solutions ULC ("**MRS**"). Additional information on MRS's involvement in the orderly wind-down process is provided further in this report and is otherwise contained in the Motion.

## **THE INTERIM RECEIVER'S ACTIONS SINCE ITS APPOINTMENT**

18. Upon being appointed by the Court, the Interim Receiver took various measures to stabilize the activities of the Company, implement control measures to safeguard the assets under its supervision, manage communications with American Apparel's stakeholders, and develop reporting metrics to monitor the Company's operations and results. In particular, the Interim Receiver took (and, as applicable, continues to take) the following actions:
- a) Contacted the Company's bank, Bank of Montreal, to obtain access to the accounts and to transfer check signing authority to the Interim Receiver;
  - b) Contacted the Company's payment processing provider, Global Payments, to obtain access to the accounts and gain an understanding of the electronic sales deposit cycle and payment processing terms and conditions;
  - c) Contacted representatives of American Apparel US to obtain an understanding of the historical daily sales and reconciliation process;
  - d) Contacted the Company's insurance broker to advise them of the Interim Receiver's appointment;
  - e) Responded to queries received on the dedicated hot-line and email address from the Company's stakeholders (employees, customers, suppliers and landlords);
  - f) Entered into retention agreements with certain key managerial and administrative employees (mainly relating to information technology, store logistics and district management) to secure their cooperation and ensure the continuity of key functions (the "**Management RAs**"). The total cost of the Management RAs is approximately \$70,000 and is reflected in the Projected Cash Flow (defined below);
  - g) Organized several teleconferences with the Company's district and store managers to inform them of the filing of the NOI, the Interim Receivership and of the anticipated course of action;
  - h) Obtained signed acknowledgements from the various stores key holders to safeguard store keys and alarm codes (the Interim Receiver did not change the locks to the stores);
  - i) Performed test inventory counts at all stores to validate the inventory quantities and evaluate internal controls over stock keeping (tests performed on a bi-weekly basis);
  - j) Arranged to obtain daily sales and inventory reports directly from the Company's systems;
  - k) Implemented a daily monitoring template to reconcile the Company's sales with the amounts deposited in its bank accounts;
  - l) Implemented a disbursement monitoring and approval process with the Company's representatives;

- m) Made an inventory of stock located in two third- party warehouses (Ontario and BC) as well as miscellaneous inventories located at the Company's head office in Montreal;
  - n) Laid-off 10 employees of AA Wholesale, given that its activities were effectively terminated at the time of the Interim Receiver's appointment.
19. As noted in greater detail below, once the Interim Receiver took the measures required to immediately safeguard the assets, an inventory monetisation plan was developed whereby the Interim Receiver engaged MRS as its agent to support the store wind-down process during the 2016 holiday season (the "**Store Wind-Down**"). Since the implementation of the Store Wind-Down, the Interim Receiver has taken the following actions:
- a) Organized and attended daily update calls with representatives of MRS and with the District Managers to address operating issues such as staffing, sales and stock availability;
  - b) Organized and attended weekly update calls with representatives of MRS to discuss strategic matters such as weekly sales and discounts, liquidation timeline and financial results;
  - c) Entered into retention agreements with certain key store employees (store managers, assistant managers and key-holders) to secure their cooperation and ensure the continuity of store operations (the "**Store RAs**"). The total cost of the Store RAs is approximately \$150,000 and is reflected in the Projected Cash Flow;
  - d) In conjunction with representatives of MRS and of American Apparel, developed on a weekly basis, a store level liquidation timeline based on sales experience and inventory levels;
  - e) On December 1, 2016, prepared and sent to various lessors, Notices Disclaim or Resiliate Leases pursuant to section 65.2 of the BIA. In all, such notices were sent to the Company's landlords in respect of 8 stores that are scheduled to be vacated on December 31, 2016 (the "**Dec 31 Stores**");
  - f) Between December 1, 2016 and the date of this report, notified the store employees of the Dec 31 Stores of their termination on December 31, 2016, all in accordance with the applicable provincial labor laws and regulations;
  - g) Between December 1, 2016 and the date of this report, prepared and sent several Notices by Debtor to Disclaim or Resiliate an Agreement (section 65.11 of the BIA) to cancel any agreements for services performed at the Dec 31 Stores;
  - h) Communicated with the Company's landlords as required to keep them apprised of the situation;
  - i) In conjunction with representatives of MRS and of American Apparel, and based on sales and inventory levels, developed an "inventory store transfer" matrix to plan for the transfer of goods between stores and thus enhance each store's product mix and offering.

## **THE COMPANY'S STORE WIND-DOWN PROCESS**

20. As noted above, at the time of the filing of the NOI (and of the appointment of the Interim Receiver), American Apparel's stores were no longer receiving any new product from their sole supplier, American Apparel US.
21. Within this context, an inventory monetisation program had to be developed that considered the inventory procurement constraint, the time of the year (holiday season), the store operating costs, as well as the customer activity in each store, all while preserving some of the operating structure in the event the Sale Process results in bids for some or all of the Canadian operations.
22. American Apparel, now cut-off from its parent which historically provided it with promotional support, marketing strategy and merchant support, no longer possesses all of the required knowledge and expertise to effectively conduct the Store Wind Down.
23. As time was of the essence and in order to ensure that the Company and the Interim Receiver had the support they required to execute the Store Wind Down, on November 17, 2016, the Interim Receiver engaged MRS (an affiliate of Hilco Merchant Resources LLS), all in accordance with the terms of the Interim Receiver Order, as its agent . MRS is highly specialized and competent in planning and executing this type of process.
24. The Interim Receiver understands that MRS (an American entity) has in the past been involved with American Apparel US and thus is familiar with the specific type of merchandise sold by American Apparel.
25. MRS essentially acts as a project manager and assists the Company's District Managers in their day-to-day operations. In addition, MRS provides valuable guidance on the discount strategy to adopt the marketing initiatives as well as to monitor, on a regular basis, key performance indicators. MRS is remunerated on a commission basis.

## CASH FLOW RESULTS RELATIVE TO PROJECTIONS

26. Cash receipts and disbursements for the 24-day period ended December 3, 2016 as compared to the Cash Flow Projections, are summarized in the following table.

<b>American Apparel Canada Wholesale Inc. &amp; American Apparel Canada Retail Inc. (collectively, the "Company")</b>			
<b>Variance Analysis (Actuals vs. Projected Cash Flows)</b>			
<b>For the 24 day period November 10, 2016 to December 3, 2016</b>			
<b>in CAD \$000's</b>			
	<b>Actuals</b>	<b>Forecast</b>	<b>Variance</b>
<b>Cash Receipts</b>			
Retail Sales Collections	2,512	2,008	504
Accounts Receivable Collections - Wholesale	98	50	48
<b>Total Receipts</b>	<b>2,610</b>	<b>2,058</b>	<b>552</b>
<b>Cash Disbursements</b>			
Payroll and Benefits	494	541	46
Occupancy Costs	618	927	309
Operating Costs	244	599	355
Security Deposits	-	100	100
Restructuring Fees	491	554	63
Sales Tax Remittances (Refund)	-	(30)	(30)
<b>Total Disbursements</b>	<b>1,847</b>	<b>2,691</b>	<b>844</b>
<b>Net Cash Flow</b>	<b>763</b>	<b>(633)</b>	<b>1,396</b>
<b>Cash Position</b>			
Opening Cash Position (Net of Outstanding Cheques)	636	636	-
Net Cash Flow	763	(633)	1,396
<b>Closing Cash Position</b>	<b>1,399</b>	<b>3</b>	<b>1,396</b>

27. As at December 3, 2016, the Debtors' cash balance (on a book basis) was approximately \$1.4 million, net of checks in circulation of approximately \$630,000, primarily relating to the December rent payments.
28. The net cash flow during the period was approximately \$1.4 million higher than projected. The primary reasons for the favourable net cash flow variance are summarized below.
- a) Total cash receipts during the period were approximately \$552,000 higher than projected primarily due to higher than expected sales by the stores;
  - b) Total cash disbursements during the period were approximately \$844,000 lower than projected, mainly due to timing differences for occupancy costs, operating expenses security deposits and restructuring fees, most of which are expected to reverse in the period covered by the Projected Cash Flow.
29. The Company has paid, and continues to pay for any goods and services received subsequent to the date of filing of the NOI, including rent, payroll and related deductions, as well as earned vacation pay.

**UPDATED CASH FLOW PROJECTIONS**

30. The Interim Receiver, with the assistance of the Company and MRS, has prepared the updated cash flow projections for the period commencing December 4, 2016 and ending on January 28, 2017 (the “**Projected Cash Flow**”). The Projected Cash Flow is summarized in the following table. A copy of the notes to the Projected Cash Flow as well as the statutory reports of the Interim Receiver and the Company are attached hereto as Appendix B.

<b>American Apparel Canada Wholesale Inc. &amp; American Apparel Canada Retail Inc. (collectively, the "Company") Summary Consolidated Cash Flow Projections For the period December 4, 2016 to January 28, 2017 in CAD \$000's</b>	
<b>Projected Cash Receipts</b>	
Retail Sales Collections	5,898
Accounts Receivable Collections - Wholesale	50
<b>Total Receipts</b>	<b>5,948</b>
<b>Projected Cash Disbursements</b>	
Payroll and Benefits	1,232
Occupancy Costs	944
Operating Costs	1,146
Security Deposits	100
Restructuring Fees	976
Sales Tax Remittances (Refund)	390
<b>Total Disbursements</b>	<b>4,788</b>
<b>Projected Net Cash Flow</b>	<b>1,161</b>
<b>Cash Position</b>	
Opening Cash Position (Net of Outstanding Cheques)	1,399
Projected Net Cash Flow	1,161
<b>Projected Closing Cash Position</b>	<b>2,560</b>

To be read in conjunction with the attached Summary of Notes and Assumptions

31. The Interim Receiver notes the following with respect to the Projected Cash Flow:
- a) The Company's cash balance as at December 3, 2016 was approximately \$1.4 million, net of checks in circulation of approximately \$630,000, primarily relating to the December rent payments;
  - b) The Projected Cash Flow reflect that during the reference period, the Company will have total receipts of approximately \$5.95 million, which consist primarily of retail sales collections;
  - c) The projected disbursements during the same period total approximately \$4.8 million and reflect all timing related variances since the date of filing, as well as the payment of post-filing expenses, including occupancy costs and payroll.
  - d) The projected net cash flows over the period total \$1.16 million.
32. Based on the Projected Cash Flow, the Company has sufficient liquidities to fund its operating activities during the First Extension Period.



## **REQUEST FOR AN EXTENSION OF THE DELAY**

33. The Company is seeking a 45-day extension to file its proposal, as it continues its restructuring process. In particular, it is seeking an order for the First Extension Period to allow it to continue the Store Wind Down during the key holiday period, under the supervision of the Interim Receiver.
34. The Company and the Interim Receiver are of the view that the ongoing Store Wind Down being conducted with the support of MRS, under the direction of the Interim Receiver, is the best way to optimize value for the Company's stakeholders, while also maintaining the Canadian operations during the pendency of the Sale Process, the outcome of which remains unknown.
35. The period covered by the First Extension Period covers the 2016 holiday season, which is the ideal timing during which to maximize the realization of the Company's inventory;
36. The Company is current on its payment of sales taxes, occupation rent and salaries, and has the liquidity to fund ongoing taxes occupation rent and salaries through the First Extension Period.
37. The Interim Receiver, a Court appointed officer, has control over the Company's business and operations, including the control over the receipts and disbursements.
38. The Company and the Interim Receiver are of the view that no creditors are expected to be materially prejudiced by the granting of the First Extension Period. There would however likely be significant prejudice to the Company's employees, landlords and other stakeholders if the stay is not extended, the Company becomes bankrupt, and the Store Wind Down and the potential for coordination with the Chapter 11 Proceedings lost.
39. As the Chapter 11 Proceedings and the Sales Process progress and the Debtors' inventory is more fully liquidated and consolidated in high-performing stores, it is expected that a viable proposal that is likely to be accepted by the Debtors' creditors can then be made.
40. The Company has conducted itself in good faith and with due diligence.

## **CONCLUSIONS AND RECOMMENDATIONS**

41. The Interim Receiver supports the relief sought by the Company in its Motion, for the following reasons:
  - a) The Company has and continues to act in good faith and with due diligence;
  - b) Without such relief, it will not be in a position to make a viable proposal in due course;
  - c) No creditor would be materially prejudiced should the Motion be granted.
42. In addition, should the Motion not be granted, the Company would become bankrupt, which may negatively affect the Chapter 11 Sale Process, thus potentially harming the recovery to American Apparel's creditors.
43. Conversely, there is no advantage to any of American Apparel's creditors in the event of a bankruptcy, which in fact would deprive certain stakeholders, such as landlords and employees, of amounts that would otherwise be received for current services.

All of which is respectively submitted this 8th of December, 2016.

**KPMG INC.**, in its capacity  
of Trustee and Interim Receiver  
of American Apparel Canada Retail Inc.  
and American Apparel Canada Wholesale Inc.

Per:  Dev A. Coossa, CIRP, LIT  
Partner

**APPENDIX A      INTERIM RECEIVER MOTION**

**APPENDIX B            NOTES TO THE PROJECTED CASH FLOW AND STATUTORY  
REPORTS OF THE INTERIM RECEIVER AND THE COMPANY**