AMERICAN REAL ESTATE PARTNERS L P
Form 8-K/A
October 21, 2005

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 8-K/A
CURRENT REPORT
Pursuant to Section 13 or 15(d) of the
Securities Exchange Act of 1934
Date of Report (Date of Earliest Event Reported): August 8, 2005
American Real Estate Partners, L.P.

(Exact name of registrant as specified in its charter)

Delaware	**1-9516**	**13-3398766**
(State or other jurisdiction of incorporation)	*(Commission File Number)*	*(IRS Employer Identification No.)*

100 South Bedford Road, Mt. Kisco, NY 10549
(Address of principal executive offices) (Zip Code)
Registrant s telephone number, including area code: **(914) 242-7700**
N/A

(Former name or former address, if changed since last report)
Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

o Written communication pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

o Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

o Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

o Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

On August 12, 2005, we filed a Form 8-K under Item 2.01 to report the completion on August 8, 2005 of the purchase of substantially all the assets of WestPoint Stevens Inc. In response to parts (a) and (b) of Item 9.01 of such Form 8-K, we stated that we would file the required financial information by amendment, as permitted by Item 9.01. This Form 8-K amendment is being filed to provide the financial statements of WestPoint Stevens and pro forma financial data for American Real Estate Partners, L.P.

Section 9 Financial Statements and Exhibits

Item 9.01 Financial Statements and Exhibits

(a) Financial statements of businesses acquired.

The following financial statements of WestPoint Stevens are filed on the pages listed below.

WestPoint Stevens, Inc.

(b) Pro forma financial information.

The following required pro forma financial data are filed on the pages listed below.

Unaudited Pro Forma Consolidated Financial Data for American Real Estate Partners, L.P. and Subsidiaries

Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders
WestPoint Stevens Inc.

We have audited the accompanying consolidated balance sheets of WestPoint Stevens Inc. and subsidiaries as of December 31, 2004 and 2003, and the related consolidated statements of operations, net stockholders deficiency, and cash flows for each of the three years in the period ended December 31, 2004. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company s internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of WestPoint Stevens Inc. and subsidiaries at December 31, 2004 and 2003, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2004, in conformity with accounting principles generally accepted in the United States.

As discussed in Note 1, the Company restated its financial statements for the years ended December 31, 2003 and 2002.

The accompanying financial statements have been prepared assuming that WestPoint Stevens Inc. will continue as a going concern. As discussed in Note 2 to the financial statements, on June 1, 2003, the Company filed a voluntary petition for relief under chapter 11 of the United States Bankruptcy Code (chapter 11). The Company has operated its business under the jurisdiction of chapter 11 and the United States Bankruptcy Court in the Southern District of New York (the Bankruptcy Court). Accordingly, substantial doubt existed regarding the Company s ability to continue as a going concern. The accompanying financial statements do not include any adjustments relating to the recoverability and classification of asset carrying amounts or the amount and classification of liabilities that may result from the outcome of this uncertainty. As discussed in Note 18 to the financial statements, the U.S. Bankruptcy Court approved the sale of substantially all of the Company s assets on August 8, 2005.

/s/ Ernst & Young LLP

Atlanta, Georgia
August 3, 2005 except
Note 18 as to which
the date is August 8, 2005

WESTPOINT STEVENS INC.
CONSOLIDATED BALANCE SHEETS

	December 31, 2004	December 31, 2003 (As Restated) (Note 1)
	(In thousands, except share data)	
ASSETS		
Current Assets		
Cash and cash equivalents	$ 10,632	$ 3,660
Accounts receivable, net (less allowances of $14,045 and $17,624, respectively)	210,497	243,507
Inventories, net	312,649	368,620
Prepaid expenses and other current assets	17,031	21,636
Total current assets	550,809	637,423
Property, Plant and Equipment		
Land	6,747	6,746
Buildings and improvements	352,601	360,234
Machinery and equipment	983,751	1,029,532
Leasehold improvements	11,226	11,581
	1,354,325	1,408,093
Less accumulated depreciation and amortization	(834,919)	(780,637)
Net property, plant and equipment	519,406	627,456
Other Assets		
Deferred financing fees, net (less accumulated amortization of $38,506 and $25,522, respectively)	1,353	12,837
Other assets	394	1,737
Total other assets	1,747	14,574
	$ 1,071,962	$ 1,279,453

See accompanying notes.

WESTPOINT STEVENS INC.
CONSOLIDATED BALANCE SHEETS

	December 31, 2004	December 31, 2003 (As Restated) (Note 1)
	(In thousands, except share data)	
LIABILITIES AND NET STOCKHOLDERS DEFICIENCY		
Current Liabilities		
Senior Credit Facility	$ 483,897	$ 490,689
Second-Lien Facility	165,000	165,000
DIP Credit Agreement	58,149	89,017
Accrued interest payable	507	295
Accounts payable	50,038	56,198
Accrued employee compensation	53,954	26,777
Pension liabilities	14,128	24,912
Accrued customer incentives	24,737	33,047
Other accrued liabilities	35,498	30,316
Total current liabilities	885,908	916,251
Noncurrent Liabilities		
Deferred income taxes and other related reserves		53,567
Pension liabilities	112,137	96,879
Other liabilities	33,158	36,168
Total noncurrent liabilities	145,295	186,614
Liabilities Subject to Compromise	1,087,808	1,085,186
Net Stockholders Deficiency		
Common Stock and capital in excess of par value:		
Common Stock, $.01 par value; 200,000,000 shares authorized; 71,099,649 shares issued	457,966	404,399
Accumulated deficit	(973,800)	(790,525)
Treasury stock; 21,202,240 shares at cost	(416,133)	(416,133)
Accumulated other comprehensive loss	(115,082)	(106,339)
Net stockholders deficiency	(1,047,049)	(908,598)
	$ 1,071,962	$ 1,279,453

See accompanying notes.

WESTPOINT STEVENS INC.
CONSOLIDATED STATEMENTS OF OPERATIONS

	Year Ended December 31,		
	2004	2003	2002
		(As Restated) (Note 1)	(As Restated) (Note 1)
	(In thousands, except per share data)		
Net sales	$ 1,618,684	$ 1,646,202	$ 1,811,357
Cost of goods sold	1,412,060	1,388,249	1,417,784
Gross earnings	206,624	257,953	393,573
Selling, general and administrative expenses	209,634	231,536	264,650
Restructuring and impairment charges	54,396	22,733	6,634
Goodwill impairment charge		46,298	
Operating (loss) earnings	(57,406)	(42,614)	122,289
Interest expense (contractual interest of $157,013 for the year ended December 31, 2004 and $148,270 for the year ended December 31, 2003)	78,263	101,972	135,476
Other expense-net	7,826	17,606	6,592
Chapter 11 expenses	34,605	31,481	
Loss from operations before income tax expense (benefit)	(178,100)	(193,673)	(19,779)
Income tax expense (benefit)	5,175	(10,785)	(4,276)
Net loss	$ (183,275)	$ (182,888)	$ (15,503)
Basic and diluted net loss per common share	$ (3.67)	$ (3.67)	$ (.31)
Basic and diluted average common shares outstanding	49,897	49,886	49,667

See accompanying notes.

WESTPOINT STEVENS INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Year Ended December 31,		
	2004	**2003** (As Restated) (Note 1)	**2002** (As Restated) (Note 1)
Cash flows from operating activities:			
Net loss	$ (183,275)	$ (182,888)	$ (15,503)
Adjustments to reconcile net loss to net cash provided by (used for) operating activities:			
Depreciation	106,799	95,335	79,225
Gain on sale of assets	(6,267)	(569)	(1,234)
Deferred income taxes	5,236	(10,899)	1,865
Non-cash component of restructuring and impairment charges	17,350	6,999	4,445
Goodwill impairment charge		46,298	
Changes in assets and liabilities excluding the effect of acquisitions, dispositions and the Trade Receivables Program:			
Accounts receivable	33,010	19,044	(4,815)
Inventories	55,971	123	28,449
Prepaid expenses and other current assets	1,772	(11,578)	2,886
Accrued interest payable	395	32,476	93
Accounts payable and other accrued liabilities	14,263	46,716	(7,946)
Other-net	9,065	7,594	12,174
Total adjustments	237,594	231,539	115,142
Net cash provided by operating activities	54,319	48,651	99,639
Cash flows from investing activities:			
Capital expenditures	(17,748)	(18,679)	(46,231)
Net proceeds from sale of assets	8,061	631	2,024
Net cash used for investing activities	(9,687)	(18,048)	(44,207)
Cash flows from financing activities:			
Senior Credit Facility:			
Borrowings		720,333	794,581
Repayments	(6,792)	(677,439)	(854,287)
DIP Credit Agreement:			
Borrowings	760,338	513,460	
Repayments	(791,206)	(424,443)	
Fees associated with DIP Agreement		(5,150)	

Trade Receivables Program				(154,800)		2,200
Net cash used for financing activities		(37,660)		(28,039)		(57,506)
Net increase (decrease) in cash and cash equivalents		6,972		2,564		(2,074)
Cash and cash equivalents at beginning of year		3,660		1,096		3,170
Cash and cash equivalents at end of year	$	10,632	$	3,660	$	1,096

See accompanying notes.

WESTPOINT STEVENS INC.
CONSOLIDATED STATEMENTS OF NET STOCKHOLDERS DEFICIENCY
(In thousands)

	Common Shares	Common Stock and Capital in Excess of Par Value	Treasury Stock Shares	Treasury Stock Amount	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Unearned Compensation	Total
Balance, December 31, 2001, (As Previously Reported)	71,000	$ 395,903	(21,529)	$ (418,781)	$ (680,789)	$ (69,386)	$ (5,314)	$ (778,367)
Restatement (Note 1)					88,965			88,965
Balance, January 1, 2002 (As Restated) (Note 1)	71,100	395,903	(21,529)	(418,781)	(591,824)	(69,386)	(5,314)	(689,402)
Comprehensive income (loss):								
Net loss (As Restated) (Note 1)					(15,503)			(15,503)
Minimum pension liability adjustment, net of tax of $16,773						(29,820)		(29,820)
Foreign currency translation adjustment						(2,765)		(2,765)
Cash flow hedges:								
Net derivative gains, net of tax of $1,346						2,390		2,390
Comprehensive loss								(45,698)

Issuance of stock pursuant to Stock Bonus Plan including tax expense		822	72	765				1,587
Issuance of Restricted Stock		(34)	8	52			(18)	
Amortization of compensation							1,891	1,891
Net operating loss benefit		12,300						12,300
Stock dividends pursuant to Stock Bonus Plan					(204)			(204)
Balance, December 31, 2002 (As Restated) (Note 1)	71,100	408,991	(21,449)	(417,964)	(607,531)	(99,581)	(3,441)	(719,526)
Comprehensive income (loss):								
Net loss (As Restated) (Note 1)					(182,888)			(182,888)
Minimum pension liability adjustment, net of tax of $3,063						(5,446)		(5,446)
Foreign currency translation adjustment						2,429		2,429
Cash flow hedges:								
Net derivative losses, net of tax of $2,104						(3,741)		(3,741)
Comprehensive loss								(189,646)

Issuance of stock pursuant to Stock Bonus Plan including tax expense		446	39	413				859
Issuance of stock pursuant to pension plan		(1,254)	202	1,381				127
Issuance of Restricted Stock, net		(3,784)	6	37			2,185	(1,562)
Amortization of compensation							1,256	1,256
Stock dividends pursuant to Stock Bonus Plan					(106)			(106)
Balance, December 31, 2003 (As Restated) (Note 1)	71,100	404,399	(21,202)	(416,133)	(790,525)	(106,339)		(908,598)
Comprehensive income (loss):								
Net loss					(183,275)			(183,275)
Minimum pension liability adjustment net of tax of $4,209						(7,482)		(7,482)
Foreign currency translation adjustment						563		563
Cash flow hedges:								
Net derivative losses, net of tax of $1,027						(1,824)		(1,824)
Comprehensive loss								(192,018)

Net operating loss benefit		53,567						53,567
Balance, December 31, 2004	71,100	$ 457,966	(21,202)	$ (416,133)	$ (973,800)	$ (115,082)	$	$ (1,047,049)

See accompanying notes.

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WESTPOINT STEVENS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Business. WestPoint Stevens Inc. (the Company) is a manufacturer and marketer of bed and bath products, including sheets, pillowcases, comforters, blankets, bedspreads, pillows, mattress pads, towels and related products. The Company conducts its operations in the consumer home fashions (bed and bath products) industry.

Basis of Presentation. The Company s consolidated financial statements are prepared on a going concern basis. See Note 2. Chapter 11 Filing for a further discussion.

Restatement of Financial Statements. During 2004, the Company determined that certain of its previously issued financial statements required restatement as a result of the Company s reserve for income tax contingencies and certain other reserves being previously recorded at amounts in excess of the amounts permitted under generally accepted accounting principles. In connection with the Company s emergence from a previous bankruptcy filing in September 1992, it applied the provisions of SOP 90-7, and recorded liabilities for certain income tax and other matters which, at such time, the Company concluded were estimable and probable of occurrence. In 2004, the Company concluded that a restatement was required due to a misapplication of accounting principles in connection with the preparation of its financial statements in prior years. Such misapplication of accounting principles led to the reserve for income tax contingencies and other reserves being overstated by $80.8 million and $4.5 million (net of income taxes of $2.8 million), respectively. As a result of these reserves initially being established with a corresponding increase to accumulated deficit (after reflecting the impact of the amortization of excess reorganization value), the restated financial statements adjust the related liabilities with a corresponding decrease to accumulated deficit. At January 1, 2002, the cumulative impact of the restatement on the Company s accumulated deficit reduced the previously reported accumulated deficit by approximately $85.3 million. The restatement results in the need to establish valuation allowances for deferred tax assets in 2003 that previously were established in 2004. Such restatement adjustment is a non-cash activity for purposes of the statement of cash flows. See Note 6, Income Taxes.

The Company restated its 2003 financial statements (i) to reclassify $4.0 million of translation losses, which were previously reported as a component of accumulated other comprehensive loss within net stockholders deficiency into earnings as a result of the permanent conversion of foreign denominated debt into US dollars (see Note 12), (ii) to reverse a fixed asset restructuring charge recorded in 2003 aggregating $37.0 million and record accelerated depreciation expense of $26.0 million in 2003 and $11.0 million in 2004 based on the remaining depreciable lives of the fixed assets (see Note 13) and (iii) to record restructuring charges related to employee termination benefits aggregating $6.1 million in 2003 that were previously recorded in 2004 (see Note 12). The Company also restated its accumulated deficit as of January 1, 2002 to reduce its workers compensation reserves by $3.7 million (net of income taxes of $2.3 million) with a corresponding decrease to accumulated deficit as the Company determined such reserves were overstated, and were previously recognized in 2004. The Company concluded that a restatement was required due to a misapplication of accounting principles in connection with the preparation of its financial statements in prior years.

WESTPOINT STEVENS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following tables reflect the impact of the restatements on the relevant captions from the Company s financial statements as of and for the years December 31, 2003 and 2002 (in thousands of dollars, except per share data):

Changes to Statements of Operations

	Year Ended December 31, 2003			Year Ended December 31, 2002		
	As Reported	Adjustments	As Restated	As Reported	Adjustments	As Restated
Cost of goods sold	$ 1,362,325	$ 25,924	$ 1,388,249	$ 1,417,784	$	$ 1,417,784
Restructuring and impairment charge	$ 49,613	$ (26,880)	$ 22,733	$ 6,634	$	$ 6,634
Loss from operations before income tax expense (benefit)	$ (194,629)	$ 956	$ (193,673)	$ (19,779)	$	$ (19,779)
Income tax expense (benefit)	$ (61,345)	$ 50,560	$ (10,785)	$ (7,120)	$ 2,844	$ (4,276)
Net loss	$ (133,284)	$ (49,604)	$ (182,888)	$ (12,659)	$ (2,844)	$ (15,503)
Basic and diluted net loss per common share	$ (2.67)	$ (1.00)	$ (3.67)	$ (0.25)	$ (0.06)	$ (0.31)

Changes to Balance Sheets

	December 31, 2003			December 31, 2002		
	As Reported	Adjustments	As Restated	As Reported	Adjustments	As Restated
Current Assets:						
Prepaid expenses and other current assets	$ 32,996	$ (11,360)	$ 21,636	$ 33,111	$	$ 33,111
Property, Plant and Equipment:						
Buildings	$ 343,441	$ 16,793	$ 360,234	$ 359,395	$	$ 359,395
Machinery and equipment	$ 1,009,367	$ 20,165	$ 1,029,532	$ 1,032,299	$	$ 1,032,299
Accumulated depreciation	$ (754,713)	$ (25,924)	$ (780,637)	$ (700,036)	$	$ (700,036)
Current Liabilities:						
Accrued employee compensation	$ 20,719	$ 6,058	$ 26,777	$ 22,623	$	$ 22,623
Other accrued liabilities	$ 33,053	$ (2,737)	$ 30,316	$ 55,676	$ (3,937)	$ 51,739
Noncurrent Liabilities:						
	$ 87,179	$ (33,612)	$ 53,567	$ 158,244	$ (72,812)	$ 85,432

Deferred income taxes and other related reserves												
Other liabilities	$	45,057	$	(8,889)	$	36,168	$	59,002	$	(9,372)	$	49,630
Liabilities Subject to Compromise	$	1,086,869	$	(1,683)	$	1,085,186	$		$		$	
Net Stockholders Deficiency:												
Accumulated deficit	$	(827,042)	$	36,517	$	(790,525)	$	(693,652)	$	86,121	$	(607,531)
Accumulated other comprehensive income (loss)	$	(110,359)	$	4,020	$	(106,339)	$	(99,581)	$		$	(99,581)

The restatement did not result in any changes to the net cash flows from operations, investing or financing activities in the Statements of Cash Flows for the years ended December 31, 2003 and 2002, although it did impact certain components of net cash flows from operations for such years.

As a result of the adjustments discussed above, modifications were also required to previously reported footnotes as follows: Note 2, Note 6, Note 7 and Note 14.

WESTPOINT STEVENS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Principles of Consolidation. The consolidated financial statements of the Company include the accounts of the Company and all of its subsidiaries. All material intercompany accounts and transactions have been eliminated.

Use of Estimates. The preparation of the financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates and such differences could be material.

Reclassifications. Certain amounts in the prior year financial statements have been reclassified to conform to the current year presentation.

Concentrations of Credit Risk. Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash investments and trade accounts receivable.

The Company maintains cash and cash equivalents and certain other financial instruments with various financial institutions. The Company performs periodic evaluations of the relative credit standing of those financial institutions that are considered in the Company s investment strategy.

Concentrations of credit risk with respect to trade accounts receivable are limited due to the large number of entities comprising the Company s customer base, however, as of December 31, 2004, substantially all of the Company s receivables were from companies in the retail industry. The Company performs periodic credit evaluations of its customers financial condition and generally does not require collateral.

Cash and Cash Equivalents. The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. These investments are carried at cost, which approximates market value.

Accounts Receivable. Accounts receivable consist primarily of trade receivables. An allowance for doubtful accounts has been established based on the Company s collection experience and an assessment of the collectibility of specific accounts. The Company evaluates the collectibility of accounts based on a combination of factors. The allowance is adjusted when the Company becomes aware of a specific customer s ability to meet its financial obligations or as a result of changes in the overall aging of accounts receivable. Accounts receivable are charged off against the allowance for doubtful accounts when it is probable the receivable will not be recovered.

Inventories. Inventory costs include material, labor and factory overhead. Inventories are stated at the lower of cost or market (net realizable value). At December 31, 2004, and 2003, approximately 88.0% and 92.8%, respectively, of the Company s inventories are valued using the dollar value last-in, first-out (LIFO) method. The remaining inventories (approximately $37.6 million and $26.6 million at December 31, 2004, and 2003, respectively) are valued using the first-in, first-out (FIFO) method. All inventories are valued at the lower of cost or market.

Inventories consisted of the following (in thousands of dollars):

	December 31,	
	2004	**2003**
Finished goods	$ 127,499	$ 144,613
Work in process	142,016	176,062
Raw materials and supplies	43,134	47,945
LIFO reserve		
	$ 312,649	$ 368,620

WESTPOINT STEVENS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Property, Plant and Equipment. As a result of the adoption of Fresh Start reporting, as of September 30, 1992, property, plant and equipment were adjusted to their estimated fair values and historical accumulated depreciation was eliminated. Additions since September 30, 1992, are stated at cost.

Depreciation is computed over estimated useful lives using the straight-line method for financial reporting purposes and accelerated methods for income tax reporting. Depreciation expense was approximately $106.8 million, $95.3 million and $79.2 million in the years ended December 31, 2004, 2003 and 2002, respectively. See Note 13. Impairment of Long-Lived Assets and Accelerated Depreciation Expense.

Estimated useful lives for property, plant and equipment are as follows:

Buildings and improvements	10 to 40 Years
Machinery and equipment	3 to 18 Years
Leasehold improvements	Lease Terms

Derivatives. Statement of Financial Accounting Standard (Statement) No. 133, *Accounting for Derivative Instruments and Hedging Activities,* as amended by Statement 137 and Statement 138 requires the Company to recognize all derivative instruments on the balance sheets at fair value. These statements also establish accounting rules for hedging instruments, which depend on the nature of the hedge relationship. A fair value hedge requires that the effective portion of the change in the fair value of a derivative instrument be offset against the change in the fair value of the underlying asset, liability, or firm commitment being hedged through earnings. A cash flow hedge requires that the effective portion of the change in the fair value of a derivative instrument be recognized in Other Comprehensive Income (OCI), a component of Net Stockholders Deficiency, and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. The ineffective portion of a derivative instrument s change in fair value is immediately recognized in earnings. See Note 8. Derivatives.

Income Taxes. The Company accounts for income taxes under Statement No. 109, *Accounting for Income Taxes.* Under Statement 109, deferred income taxes are provided at the enacted marginal rates on the differences between the financial statement and income tax bases of assets and liabilities. See Note 6. Income Taxes.

Pension Plans. The Company has defined benefit pension plans covering essentially all employees. The benefits are based on years of service and compensation. The Company s practice is to fund amounts that are required by the Employee Retirement Income Security Act of 1974. See Note 4. Employee Benefit Plans Pension Plans.

The Company also sponsors an employee savings plan covering eligible employees who elect to participate. Participants in this plan make contributions as a percent of earnings. The Company matches certain amounts of employee contributions. See Note 4. Employee Benefit Plans Retirement Savings Plan.

Other Employee Benefits. The Company accounts for post-retirement and post-employment benefits in accordance with Statement No. 106, *Employer s Accounting for Post Retirement Benefits Other Than Pensions* and Statement No. 112, *Employer s Accounting for Postemployment Benefits.* See Note 4. Employee Benefit Plans Other Post-Retirement Benefit Plans.

Stock-Based Compensation. The Company grants stock options for a fixed number of shares in accordance with certain of its benefit plans. The Company accounts for stock option grants in accordance with Statement No. 123, *Accounting for Stock-Based Compensation,* which permits the recognition provisions of APB Opinion No. 25, *Accounting for Stock Issued to Employees,* and, accordingly, recognizes no compensation expense for the stock option grants if the exercise price is equal to or more than the fair value of the shares at the date of grant. Pro forma information regarding net income and earnings per share, as calculated under

WESTPOINT STEVENS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

the provisions of Statement No. 123, as amended by Statement 148, are disclosed in Note 7. Net Stockholders Deficiency.

Fair Value Disclosures. Cash and cash equivalents: The carrying amounts reported in the balance sheets for cash and cash equivalents approximate its fair value due to the short maturity of these instruments.

Accounts receivable and accounts payable: The carrying amounts reported in the balance sheets for accounts receivable and accounts payable approximate their fair value due to the short maturity of these instruments.

Long-term and short-term debt: The fair value of the Company s outstanding debt is estimated based on the quoted market prices for the same issues where available or based on estimates by management. The fair value of the $1,707.0 million and $1,744.7 million of outstanding debt at December 31, 2004, and 2003 was approximately $533.2 million and $813.1 million, respectively.

Goodwill and Other Intangible Assets. Effective January 1, 2002, the Company adopted the requirements of Statement No. 141, *Business Combinations*, and No. 142, *Goodwill and Other Intangible Assets*, effective for fiscal years beginning after December 15, 2001. Statement 141 includes guidance on the initial recognition and measurement of goodwill and other intangible assets arising from business combinations completed after June 30, 2001. Statement 142 prohibits the amortization of goodwill and intangible assets with indefinite useful lives. Goodwill (and intangible assets deemed to have indefinite lives) are no longer amortized but are subject to annual impairment tests in accordance with the Statement. Other intangible assets will continue to be amortized over their remaining useful lives.

The Company applied Statement 142 beginning in the first quarter of 2002. The Company is required to test goodwill for impairment using the two-step process prescribed in Statement 142. The first step is a screen for potential impairment, while the second step measures the amount of the impairment, if any. In accordance with Statement 142, the Company was required to perform the first step of the required January 1, 2002, impairment test of goodwill by June 30, 2002. The Company completed the transitional goodwill impairment test required and determined that there was no impairment of its recorded goodwill balances at that time. The Company performed the first required annual goodwill impairment test during the fourth quarter of 2002 and further determined that there was no impairment to its recorded goodwill balances at that time.

As a result of certain triggering events that occurred during the second quarter of 2003, including the Company filing a petition for reorganization under chapter 11 of the Bankruptcy Code (see Note 2, Chapter 11 Filing), the Company performed an interim test of the carrying amount of its goodwill in accordance with Statement No. 142. Based on a valuation of the Company s enterprise value using quoted market prices of the Company s debt and equity securities and the identification of qualifying intangibles, all of the Company s goodwill was deemed to be impaired and was subsequently written off. The unamortized balance of the goodwill that was written off during the quarter ended June 30, 2003, amounted to $46.3 million and is classified separately in the accompanying consolidated statement of operations.

Impairment of Long-Lived Assets. Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. The Company evaluates the recoverability of its long-lived assets and related goodwill by comparing estimated future undiscounted cash flows with the asset s carrying amount to determine if impairment exists. Impairment, if any, is then measured by comparing carrying value to market value or is estimated based on discounted cash flow analyses. See Note 13. Impairment of Long-Lived Assets and Accelerated Depreciation Expense.

Revenue Recognition. The Company records revenue when the following criteria are met: persuasive evidence of an arrangement exists, delivery has occurred, the Company s price to the customer is fixed and determinable, and collectibility is reasonably assured. Delivery is not considered to have occurred until the customer assumes the risks and rewards of ownership. Customers take delivery at the time of shipment for

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terms designated free on board shipping point. For sales designated free on board destination, customers take delivery when the product is delivered to the customer s delivery site. Provisions for certain rebates, sales incentives, product returns and discounts to customers are recorded in the same period the related revenue is recorded.

The Company provides for limited product return rights to certain distributors and customers primarily for slow moving or damaged items subject to certain defined criteria. The Company monitors product returns and records a provision for the estimated amount of future returns at the time revenue is recognized based primarily on historical experience and specific notification of pending returns. Although historical product returns generally have been within expectations, there can be no assurance that future product returns will not exceed historical amounts. A significant increase in product returns could have a material impact on the Company s operating results in future periods.

Customer Incentives. Incentives are provided to customers primarily for new sales programs. These incentives begin to accrue when a commitment has been made to the customer and are recorded as a reduction to sales.

Earnings Per Common Share. Basic and diluted earnings per share are calculated in accordance with Statement No. 128, *Earnings per Share.* Basic earnings per share is based on the weighted average number of common shares outstanding, and diluted earnings per share includes any dilutive effects of stock options and the Company s stock bonus plan.

Segment Information. The Company is in one business segment, the consumer home fashions business, and follows the requirements of Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information.*

Advertising Costs. Advertising costs are expensed as incurred and were $8.6 million, $11.1 million and $15.0 million in 2004, 2003 and 2002, respectively.

Environmental and Legal Matters. Liabilities for environmental remediation and legal indemnification and defense costs are recognized when it is probable a liability has been incurred and the amount can be reasonably estimated. The liabilities are developed based on currently available information and reflect the participation of other potentially responsible parties, depending on the parties financial condition and probable contribution. The accruals are recorded at undiscounted amounts and are reflected as other liabilities on the accompanying consolidated balance sheets.

New Accounting Pronouncements. In January 2003, the Financial Accounting Standards Board (the FASB) released Interpretation No. 46, *Consolidation of Variable Interest Entities* (FIN 46). FIN 46 requires that all primary beneficiaries of Variable Interest Entities (VIE) consolidate that entity. FIN 46 was effective immediately for VIEs created after January 31, 2003, and to VIEs to which an enterprise obtains an interest after that date. It applied in the first fiscal year or interim period beginning after June 15, 2003, to VIEs in which an enterprise held a variable interest it acquired before February 1, 2003. In December 2003, the FASB published a revision to FIN 46 (FIN 46R) to clarify some of the provisions of the interpretation and to defer the effective date of implementation for certain entities. Under the guidance of FIN 46R, entities that do not have interests in structures that are commonly referred to as special purpose entities were required to apply the provisions of the interpretation in financial statements for periods ending after March 14, 2004. The Company does not have any interests in special purpose entities. Accordingly, when FIN 46R was adopted, it had no impact on the Company s financial statements.

On October 13, 2004, the FASB issued Statement No. 123R, *Share-Based Payment*, which requires all companies to measure compensation cost for all share-based payments (including employee stock options) at fair value, and is effective for public companies (except small business issuers as defined in SEC Regulations S-B) for annual periods beginning after June 15, 2005. A calendar-year company therefore would be required

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to apply Statement No. 123R beginning January 1, 2006 and could choose to apply Statement No. 123 retroactively. The cumulative effect of adoption, if any, would be measured and recognized on January 1, 2006. The Company is currently evaluating the impact of this standard.

Statement No. 151, *Inventory costs, an Amendment of ARB No. 43, Chapter 4*, amends ARB No. 43 to clarify that abnormal amounts of idle facility expense, freight, handling costs, and wasted materials (spoilage) should be recognized as current-period charges. In addition, this Statement requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. The provisions of this Statement shall be effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company is currently evaluating the impact of this standard.

The FASB recently issued Statement No. 154, *Accounting Changes and Error Corrections*, a replacement of APB Opinion No. 20, *Accounting Changes*, and FASB Statement No. 3, *Reporting Accounting Changes in Interim Financial Statements.* The Statement applies to all voluntary changes in accounting principle, and changes the requirements for accounting for and reporting of a change in accounting principle. Statement 154 is the result of a broader effort by the FASB to improve the comparability of cross-border financial reporting by working with the International Accounting Standards Board (IASB) toward development of a single set of accounting standards. Statement 154 requires retrospective application to prior periods financial statements of a voluntary change in accounting principle unless it is impracticable. Opinion 20 previously required that most voluntary changes in accounting principle be recognized by including in net income of the period of the change the cumulative effect of changing to the new accounting principle. Statement 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. Earlier application is permitted for accounting changes and corrections of errors made occurring in fiscal years beginning after June 1, 2005. The Statement does not change the transition provisions of any existing accounting pronouncements, including those that are in a transition phase as of the effective date of this Statement.

2. Chapter 11 Filing

On June 1, 2003 (the Petition Date), the Company and several of its subsidiaries (together with the Company, the Debtors) each commenced a voluntary case under chapter 11 of the Bankruptcy Code in the Bankruptcy Court. The Debtors were authorized to operate their businesses and manage their properties as debtors in possession pursuant to section 1107(a) and 1108 of the Bankruptcy Code. The Bankruptcy Court also approved, under interim order, access to $175 million in debtor in possession financing and subsequently approved, under final order, access to $300 million of debtor in possession financing for use by the Company, pursuant to a Post-Petition Credit Agreement, dated as of June 2, 2003, among WestPoint Stevens Inc. and certain of its subsidiaries, the financial institutions named therein and Bank of America, N.A. and Wachovia Bank, National Association (the DIP Credit Agreement).

On June 2, 2003, the Bankruptcy Court entered a number of orders enabling the Company to continue regular operations throughout the reorganization proceeding. These orders authorized, among other things, normal payment of employee salaries, wages and benefits; continued participation in workers compensation insurance programs; payment to vendors for post-petition delivery of goods and services; payment of certain pre-petition obligations to customers; and continued payment of utilities.

The Company filed a plan of reorganization on January 20, 2005 and subsequently filed an amended plan of reorganization on June 10, 2005. On August 8, 2005 the Company sold substantially all of its assets, pursuant to Section 363 of the Bankruptcy Code. See Note 18, Subsequent Events.

On August 28, 2003, one of the Company s foreign subsidiaries, WestPoint Stevens (Europe) Ltd., commenced an insolvency proceeding in the United Kingdom and is in the process of being liquidated, and

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inactive subsidiaries have applied to be dissolved. The losses associated with the closure of the foreign subsidiary are estimated to total approximately $9.3 million consisting of translation losses of $4.0 million, inventory writedowns of $3.9 million and accounts receivable writedowns for claims of $1.4 million. These charges are reflected in restructuring, impairment and other charges as discussed in Note 12.

Basis of Presentation

The Company s consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States applicable on a going concern basis. Except as otherwise disclosed, these principles assume that assets will be realized and liabilities will be discharged in the ordinary course of business. The Company s consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or the amounts and classification of liabilities that might result from the outcome of these uncertainties.

The Company s consolidated financial statements included elsewhere in this report are presented in accordance with AICPA Statement of Position 90-7 (Financial Reporting by Entities in Reorganization Under the Bankruptcy Code) (SOP 90-7). Under chapter 11 of the Bankruptcy Code, substantially all unsecured liabilities as of the Petition Date are subject to compromise or other treatment under a plan of reorganization which must be confirmed by the Bankruptcy Court after submission to any required vote by affected parties. For financial reporting purposes, the categories of liabilities and obligations whose treatment and satisfaction are dependent on the outcome of the chapter 11 case and classified as Liabilities Subject to Compromise in the consolidated balance sheets under SOP 90-7 are identified below (in thousands):

	December 31,	
	2004	**2003**
Senior Notes due 2005 and 2008:		
Senior Notes outstanding	$ 1,000,000	$ 1,000,000
Related accrued interest	36,313	36,130
Related deferred financing fees (less accumulated amortization of $16,569 and $14,052, respectively)	(4,647)	(7,164)
Total		