UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

IN RE FRIEDMAN'S, INC. SECURITIES LITIGATION	File No. 1:03-CV-3475-WSD

PLAINTIFFS' CORRECTED CONSOLIDATED AND AMENDED
CLASS ACTION COMPLAINT

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Lead Plaintiffs, by and through their attorneys, allege the following upon information and belief, except as to those allegations specifically pertaining to Lead Plaintiffs, which are alleged upon personal knowledge. Lead Plaintiffs' information and belief are based upon, among other things, their and/or counsel's investigation, which included without limitation: (a) review and analysis of filings made by Friedman's, Inc. ("Friedman's" or the "Company") and other related parties and non-parties with the Securities and Exchange Commission ("SEC"); (b) review and analysis of press releases and other publications disseminated by certain of the Defendants and other related non-parties; (c) review of news articles, shareholder communications, and postings on Friedman's website concerning Friedman's products and Friedman's statements; (d) review of other publicly available information concerning Friedman's, the other Defendants and related non-parties; (e) consultation with experts, and; (f) interviews with industry participants and Friedman's former employees. Lead Plaintiffs believe that substantial additional evidentiary support will exist for the allegations set forth herein after a reasonable opportunity for discovery. Many of the facts supporting the allegations contained herein are known only to Defendants or are within their control.

SUMMARY OF THE ACTION

1. This is a federal securities class action against Friedman's, certain of its officers and/or directors, Friedman's controlling shareholders, the Company's independent auditor, Ernst & Young, LLP ("E&Y"), and the Company's underwriters for violations of the federal securities laws. Lead Plaintiffs bring this action on behalf of themselves and all other persons or entities, except for Defendants and certain of other related non-parties as described below, who purchased Friedman's common stock during the period from January 26, 2000 through and including August 20, 2004 (the "Class" and the "Class Period"), seeking to pursue remedies under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 (the "Exchange Act"), and Rule 10b-5 promulgated thereunder against Friedman's, certain of its officers and directors, its controlling shareholders and E&Y. This action is also brought by Lead Plaintiff Allan Bortel

on behalf of two subclasses: (i) a subclass consisting of all persons who purchased or otherwise acquired the common stock of Friedman's pursuant to or traceable to the Shelf Registration Statement filed by Friedman's with the SEC on or about December 28, 2001, from which the common stock sold in the Company's February 6, 2002 and September 19, 2003 public offerings originate (the "Registration Statement"), seeking to pursue remedies under Sections 11 and 15 of the Securities Act of 1933 ("Securities Act") against Friedman's, certain of Friedman's officers and/or directors, Friedman's controlling shareholders, E&Y, and the underwriters for the two public offerings (the "Section 11 Subclass"); and (ii) a subclass consisting of all persons who purchased or otherwise acquired the common stock of Friedman's pursuant to the Registration Statement and/or the September 19, 2003 Prospectus, seeking to pursue remedies under Sections 12(a)(2) and 15 of the Securities Act, against Friedman's, certain of Friedman's officers and directors, its controlling shareholders and the underwriters of the September 19, 2003 public offering ("the Section 12(a)(2) Subclass").

2. Friedman's is the third largest specialty retailer of fine jewelry in the United States. Both prior to and during the Class Period, Friedman's was one of the companies, along with its affiliates Crescent Jewelers, Inc. ("Crescent"), EZCorp Inc. ("EZCorp") and Morgan Schiff & Co., Inc. ("Morgan Schiff"), that

were entangled in a web of deceit and fraud, all of which was orchestrated by Defendant Phillip E. Cohen, the controlling shareholder of Friedman's and its affiliates. In fact, the same individuals comprised the senior management of Friedman's and Crescent, and were controlled by and were cronies of Defendant Cohen.

3. Defendants, the senior management of Friedman's, committed the fraud based on, *inter alia*, the motive to receive incentive compensation and forgiveness on personal loans the Company provided and to raise money in two secondary offerings during the Class Period. Additionally, Morgan Schiff had consulting arrangements with both Friedman's and Crescent where they received hefty fees, which further lined Defendant Cohen's pockets.

4. Worse, Defendant Cohen used public money raised by Friedman's in order to fund his non-public affiliate Crescent, which also was engaged in a massive accounting fraud. Only when the web of deceit and fraud started to unravel did the investing public start to become aware of Defendants' massive and egregious scheme to defraud the public. The SEC and Department of Justice ("DOJ") began investigations into Friedman's accounting manipulations, including, *inter alia*, the Company's: (1) failure to write down an impairment for its investment in Crescent; (2) improper revenue recognition; (3) understatement of

the allowance for uncollectible accounts; (4) overstatement of inventory; and (5) involvement in a scheme, along with Crescent and Cosmopolitan, to defraud Capital Factors, which resulted in an understatement of Friedman's accounts payable. All of these accounting manipulations overstated the Company's reported earnings and thereby artificially inflated the price of Friedman's stock purchased by Lead Plaintiff and members of the Class. The massive accounting fraud began to unravel in September 2003. The Company was forced to announce in September 2003 that the SEC had begun an informal inquiry into Friedman's. Within two months, Friedman's announced that the SEC's informal inquiry had been expanded and upgraded to a formal investigation and the allowance for uncollectible accounts had been materially understated. This was just the tip of the iceberg. Less than a week later, on November 17, 2003, the Company announced that it would be restating its financial statements for fiscal years 2000-2002, and the first three quarters of 2003. In fact, Friedman's accounting books and records are in such disarray that it has not filed any financial statements with the SEC in over a year. Over the next several months the news got worse. The Company's publicly traded stock was delisted and then suspended. Today, Friedman's stock trades only in the OTC "pink sheets." The SEC has also issued a "Wells Notice," indicating its intention to institute a civil enforcement action against Friedman's due to the massive accounting fraud perpetrated on the unsuspecting public. The Company is in default of its credit facility, has not paid its vendors and is no longer able to obtain new inventory to conduct its operations.

5. Further evidence of Defendant's massive fraud can be found in the fact that E&Y, the long time auditors of both Friedman's and Crescent, withdrew its audit opinions of Friedman's for the 2000-2002 audits and has resigned as the auditor for Crescent. Withdrawal of an audit opinion is an extraordinary event even where a company announces a restatement. E&Y's resignation from the Crescent audit was followed by Friedman's statement that Crescent's historical financials should also not be relied upon as they contained materially false and misleading statements. Crescent has filed for bankruptcy as a result of its accounting manipulations, the same manipulations as employed by Friedman's. Morgan Schiff has been suspended as a brokerage firm from the NASD for failing to file audited financial statements.

6. As detailed at great length below, numerous former employees of Friedman's have provided details regarding the Company's impairment of its investment in Crescent, its improper revenue recognition, its understatement of the allowance for uncollectible accounts, the overstatement of inventory and the understatement of accounts payable.

7. The extent and magnitude of Friedman's fraud has yet to be fully revealed. As the truth has started to trickle out, the management at Friedman's has been in a constant whirlwind of change. The Company and E&Y also continue to struggle to reveal the full truth regarding Friedman's actual financial condition and restate Friedman's financial results. The market has reacted strongly to the partial public disclosure of this massive accounting fraud, punishing the Company's stock. Friedman's stock, at one time trading at a high of $17.50 per share during the Class Period, was trading at a mere $.78 per share as of August 20, 2004 (the last day of the Class Period).

JURISDICTION AND VENUE

8. The claims asserted herein arise under and pursuant to Sections 11, 12(a)(2) and 15 of the Securities Act, as amended, and under Sections 10(b) and 20(a) of the Exchange Act, as amended, and Rule 10b-5 promulgated thereunder (17 C.F.R. § 240.10b-5).

9. This Court has jurisdiction of this action pursuant to Section 22 of the Securities Act, Section 27 of the Exchange Act, and pursuant to 28 U.S.C. §§ 1331 and 1337.

10. Venue is proper in this District because many of the acts complained of, including the dissemination of materially false and misleading statements and

reports prepared by or with the participation, acquiescence, encouragement, cooperation, or assistance of Defendants, occurred, at least in part, in this District. In addition, Friedman's maintains its registered agent within this District. In connection with the acts and conduct alleged in this Complaint, Defendants, directly or indirectly, used the means and instrumentalities of interstate commerce, including the mails and telephonic communications and the facilities of the New York Stock Exchange (the "NYSE") and NASDAQ National Market (the "NASDAQ"), national securities exchanges.

PARTIES

Plaintiffs

11. Lead Plaintiffs Ardsley Partners, LP, Guerrilla Partners LP, The Parker Family, Doug Havel and James A. Hammann purchased Friedman's common stock, as set forth in the certifications already filed with the Court and are incorporated herein by reference.

Defendants

12. (a) Defendant Friedman's is a corporation that maintains its principal office at 171 Crossroads Parkway, Savannah, Georgia. The Company describes itself as the third largest specialty retailer of fine jewelry in the United States, operating over 700 stores in 20 states. According to the Company's SEC

filings, Friedman's offers its customers competitive prices, a broad selection of quality merchandise and a high level of customer service. The Company targets low to middle income customers, ages 18 to 45, and provides them with a selection of diamonds, gold, gemstones and wedding-related items tailored for their market. Friedman's offers a proprietary credit program to help customers finance their purchases. During the Class Period, over 50% of the Company's sales were through Friedman's proprietary credit card program. As of September 24, 2003, the Company had over 18,000,000 shares of Class A common stock, and approximately 1,200,000 shares of Class B common stock outstanding. Friedman's Class A common stock began publicly trading on the NASDAQ National Market on October 14, 1993, and in mid-2003 began trading on the New York Stock Exchange. On May 6, 2004, the NYSE halted trading in Friedman's Class A common stock. Five days later, on May 11, 2004, the NYSE suspended trading in the Company's Class A common stock. Since May 12, 2004, the Company's Class A common stock has traded in the OTC "pink sheets." Friedman's Class B common stock is privately owned as described herein, and therefore does not trade on any exchange.

(b) Defendant Victor M. Suglia ("Suglia") served as Senior Vice President, Chief Financial Officer, Treasurer and Secretary of the Company from prior to the commencement of the Class Period until he was placed on a leave of absence on November 11, 2003. One month later, in December 2003, Suglia resigned. Suglia was also at all relevant times the Chief Financial Officer of Crescent, a company affiliated with Friedman's, as described herein. Suglia was a signatory to the Company's Shelf Registration Statement filed with the SEC on or about December 28, 2001 ("Registration Statement"), from which the shares sold in the Company's two public offerings on February 6, 2002 and September 19, 2003, originate.

(c) Defendant Bradley J. Stinn ("Stinn") served as the Company's Chief Executive Officer and Chairman of the Executive Committee of the Board of Directors from prior to the beginning of the Class Period until he resigned from those positions on December 2, 2003. Defendant Stinn is also Chairman and CEO of affiliate Crescent. Stinn was a signatory to the Company's Registration Statement.

(d) Defendant Douglas Anderson ("Anderson") served as Friedman's President and Chief Operating Officer from September 2001 until he resigned from those positions on June 29, 2004.

(e) Defendant John Mauro ("Mauro") served as Friedman's and Crescent's Controller at all relevant times hereto.

(f) Defendant Richard Cartoon ("Cartoon") was Friedman's Chief Financial Officer from December 8, 2003 until his resignation on May 5, 2004.

(g) Defendants Suglia, Stinn, Anderson, Mauro and Cartoon are collectively referred to as the "Individual Defendants."

13. (a) Defendant Phillip Ean Cohen ("Cohen") controls all of Friedman's Class B common stock through his ownership of MS Jewelers Corporation, the general partner of MS Jewelers Limited Partnership, which owns all of Friedman's Class B common stock. According to Friedman's September 19, 2003 Prospectus, "Mr. Cohen controls the outcome of substantially all matters submitted to a vote of the stockholders." Defendant Cohen "has significant control over [Friedman's] business, policies and affairs, including the power to appoint new management, prevent or cause a change of control and approve any action requiring the approval of the holders of [Friedman's] common stock, including adopting amendments to [Friedman's] certificate of incorporation and approving mergers or sales of all or substantially all of [Friedman's] assets . . . In addition, Mr. Cohen, through his ownership of MS Jewelers Corporation, has the right to elect up to 75% of [Friedman's] directors. Mr. Cohen also controls Crescent through his ownership of CJ Morgan Corp., the general partner of CJ Limited Partnership, which owns substantially all of the capital stock of Crescent.

[Friedman's has] entered into agreements with Crescent, whereby [Friedman's] provide[s] Crescent with accounting and systems support services, as well as use of [Friedman's] The Value Leader trademark."

(b) Defendant MS Jewelers Corporation maintains it principal offices at 350 Park Avenue, New York, New York 10022. MS Jewelers Corporation is the general partner of Defendant MS Jewelers Limited Partnership and has the sole right to vote the shares of the Company's Class B common stock and to direct their disposition. The Class B common stock has the right to elect a majority of the Company's Board of Directors. Defendants MS Jewelers Corporation and MS Jewelers Limited Partnership are referred to collectively as "MS Jewelers."

(c) Defendant Morgan Schiff maintains its principal office at 350 Park Avenue, New York, New York 10022 (the same address as Defendant MS Jewelers Corporation). Morgan Schiff is an investment bank controlled by Defendant Cohen and is an affiliate of Friedman's. According to Friedman's January 22, 2003 Proxy Statement, MS Jewelers Limited Partnership was formed by an investor group led by the investment banking firm Morgan Schiff and its principals in order to purchase the Company's predecessor. As described in Friedman's January 22, 2003 Proxy Statement, Friedman's entered into a Financial Advisory Services Agreement with Morgan Schiff in December 1994, whereby

Morgan Schiff would provide the company with "certain financial advisory services with respect to capital structure, business strategy and operations, budgeting and financial controls, and mergers, acquisitions and other similar transactions for an annual fee of $400,000." Moreover, according to Friedman's 2001 Form 10-K, the Company agreed to indemnify Morgan Schiff against any losses associated with the Financial Advisory Services Agreement. The Company disclosed in its 2001 Form 10-K that it paid $400,000 to Morgan Schiff during fiscal years 2001, 2000, and 1999. According to the 2001 Form 10-K, the Company incurred costs of $1 million for services provided by Morgan Schiff in connection with the refinancing, the purchase warrant and the guarantee of Crescent's debt by Friedman's. On May 12, 2004, Morgan Schiff was suspended from membership in the National Association of Securities Dealers ("NASD") for failure to comply with formal written requests from the NASD to submit audited financial statements to the NASD.

(d) Defendants Cohen, MS Jewelers and Morgan Schiff are collectively referred to as the "Control Person Defendants."

14. (a) Defendant Sterling B. Brinkley ("Brinkley") served as Friedman's Chairman of the Board of Directors from prior to the commencement of the Class Period until he resigned on December 23, 2003. Upon his resignation

from Friedman's, Brinkley became interim CEO of Cohen-controlled Crescent. Throughout the relevant period, Brinkley served as Crescent's Chairman of the Board of Directors. He also is a consultant to Cohen-controlled Defendant Morgan Schiff. Mr. Brinkley is also Chairman of the Board of Directors of Cohen-controlled EZCORP, another of Friedman's affiliates. Mr. Brinkley is also chairman of the boards of directors of other private companies that are also affiliates of Morgan Schiff. Defendant Brinkley is a signatory to the Registration Statement.

(b) Defendant John E. Cay, III ("Cay") served as a director of Friedman's from prior to the commencement of the Class Period until he was removed from the Company's board of directors on May 5, 2004 by Defendant Cohen. Defendant Cay, at all relevant times hereto, has been Chairman and Chief Executive Officer of Palmer & Cay, Inc., an insurance brokerage and employee benefit consulting company that provides insurance brokerage and employee benefit consulting services to Friedman's and Crescent. Defendant Cay is a signatory to the Company's Registration Statement.

(c) Defendant Robert W. Cruickshank ("Cruickshank") served as a director of Friedman's from prior to the commencement of the Class Period until his resignation on May 26, 2004. Defendant Cruickshank is a signatory to the Company's Registration Statement.

(d) Defendant David B. Parshall ("Parshall") has served as a director of Friedman's at all relevant times hereto and is a signatory to the Company's Registration Statement.

(e) Defendant Mark C. Pickup ("Pickup") served as a director of Friedman's from prior to the commencement of the Class Period until his death in early April 2004. Defendant Pickup is a signatory to the Company's Registration Statement. Defendant Pickup also served as a director of EZCorp.

(f) Defendants Brinkley, Cay, Cruickshank, Parshall and Pickup are collectively referred to as the "Director Defendants."

15. (a) Defendants ABN AMRO Rothschild LLC, McDonald Investments Inc., and Wedbush Morgan Securities, Inc. were underwriters for Friedman's February 6, 2002 public offering.

(b) Defendants Thomas Weisel Partners LLC, McDonald Investments, Inc., JMP Securities, Wedbush Morgan Securities, Inc. and Morgan Joseph & Co. Inc were underwriters for Friedman's September 19, 2003 public offering.

(c) Defendants ABN AMRO Rothschild, LLC, McDonald Investment, Inc., JMP Securities, Wedbush Morgan Securities, Inc., Morgan Joseph & Co., Inc.

and Thomas Weisel Partners LLC are collectively referred to as the "Underwriter Defendants."

16. Defendant Ernst & Young, LLP ("E&Y") has served as the Company's independent auditor at all relevant times hereto. In connection with the Company's audited financial statements for fiscal years 2000, 2001 and 2002, E&Y rendered unqualified audit opinions which were contained in the Company's Form 10-K's for fiscal years 2000, 2001 and 2002. E&Y falsely represented to the investing public that its audits were conducted in accordance with Generally Accepted Auditing Standards and that the Company's financial statements were prepared in accordance with Generally Accepted Accounting Principles. On November 17, 2003, the Company issued a press release announcing that its historical financial statements for at least fiscal years 2000, 2001, and 2002, and for the first three quarters of fiscal year 2003 would be restated. On that same day, it was announced that E&Y was withdrawing its unqualified audit opinions rendered in connection with those annual financial statements. Defendant E&Y was also Crescent's long time independent auditor until resigning on May 15, 2004. Friedman's has publicly admitted that the financial information for Crescent previously included in Friedman's public filings should no longer be relied upon. E&Y's auditor independence, and the resulting audit opinions thereon, have been

called into question on a number of occasions. In fact, the SEC, in an administrative proceeding (File No. 3-10933) issued on April 16, 2004, found that "[t]he evidence demonstrates that it is necessary to order EY to cease and desist in order to protect public investors and the capital markets. Based on my observation of the witnesses and my review of record, I conclude that EY will likely commit future violations absent an explicit directive to cease and desist . . . In addition, the evidence shows that EY has an utter disdain for the Commission's rules and regulations on auditor independence." Moreover, the SEC ordered that E&Y:

> shall retain an independent consultant acceptable to the Commission, to work with Ernst & Young LLP to assure the Commission that Ernst & Young LLP's leadership is committed to, and has implemented policies and procedures that reasonably can be expected to remedy the violations found in this Initial Decision and result in compliance with the Commission's rules on auditor independence related to business relationships with clients and with GAAS. Ernst & Young LLP shall cooperate with the independent consultant in all respects, including staff support, and shall compensate the independent consultant, and staff, if one is necessary, at reasonable and customary rates. Once retained, Ernst & Young LLP shall not terminate the relationship with the independent consultant without Commission approval. The independent consultant shall report to the Commission in writing six months from the date work has begun as to the findings of its review and Ernst & Young LLP's efforts at correcting the violations.

Other Related Non-Parties

17. Crescent is a specialty retailer of fine jewelry based in Oakland, California. Crescent voluntarily filed for Chapter 11 bankruptcy protection on August 12, 2004. According to Friedman's September 19, 2003 Prospectus, Friedman's admits that it is "affiliated with Crescent through common controlling ownership and executive management. Phillip E. Cohen controls Crescent and is also the beneficial owner of all of [Friedman's] Class B voting common stock. In addition, [Friedman's former] Chief Executive Officer, Bradley J. Stinn, also serves as Chief Executive Officer of Crescent, and [Friedman's former] Chief Financial Officer, Victor M. Suglia, also serves as Chief Financial Officer of Crescent. [Friedman's has] contractual arrangements with Crescent under which [Friedman's] provide[s] Crescent with accounting and information technology support, certain other back-office processing services and the use of [Friedman's] The Value Leader trademark." Defendant Cohen controls Crescent through his ownership of CJ Morgan Corp., the general partner of CJ Limited Partnership, which owns substantially all of the capital stock of Crescent. Friedman's 2002 Form 10-K recognized that "our controlling stockholder and some of our directors and executive officers may have a conflict of interest as a result of their relationship with Crescent."

18. EZCORP maintains its principal offices at 1901 Capital Parkway, Austin, TX 78746, and operates a chain of pawn shop stores. Friedman's public filings disclose that EZCORP is also an affiliate of Friedman's. In EZCorp's Form 10-K for the 2003 fiscal year ended September 30, 2003, EZCorp disclosed that Morgan Schiff was also an affiliate of the general partner of the majority shareholder, which is Defendant Cohen. Moreover, in its 2003 Form 10-K, EZCorp stated that "[p]ursuant to the terms of a financial advisory services agreement, Morgan Schiff . . . provided management consulting and investment banking services to the Company for a $33,333 monthly retainer." The services included consultations with respect to offerings of the Company's securities, "including, but not limited to, the form, timing, and structure of such offerings." The 2003 Form 10-K also disclosed that Morgan Schiff earned fees in addition to its steep retainer "for other business and financial consulting services related to specific transactions."

19. Allan M. Edwards ("Edwards") was appointed to Friedman's Board of Directors on May 5, 2004, and at all times relevant hereto served as the President of Morgan Schiff.

20. Alan L. Stanzler ("Stanzler") was appointed to Friedman's Board of Directors on May 5, 2004, and resigned from the Board two days later on May 7, 2004.

21. Joseph D. McSweeney ("McSweeney") was appointed to Friedman's Board of Directors on May 5, 2004, and resigned from the Board two days later on May 7, 2004.

22. Thaddeus S. Jaroszewicz ("Jaroszewicz") served as a member of Friedman's Board of Directors from May 5, 2004, until his resignation on August 20, 2004. Jaroszewicz also serves as Chief Executive Officer of Tab Products (which sells records management services, products and equipment), and Workstream, Inc. (which manufactures and sells mailroom and office furniture and fixtures), both of which are affiliates of Friedman's controlling shareholders.

23. Peggy Brockschmidt ("Brockschmidt") served as a member of Friedman's Board of Directors from May 5, 2004, until her resignation on August 5, 2004. Brockschmidt also serves as a director of Crescent, as well as a consultant to Crescent on operational issues. From 2000 to 2003, Brockschmidt also served as a consultant to Morgan Schiff.

24. (a) The Individual Defendants and the Control Person Defendants, as officers and controlling shareholders, respectively, of a company registered with

the SEC under the federal securities laws, the common stock of which was registered with the SEC, traded on the NASDAQ and/or NYSE, and governed by the provisions of the federal securities laws, were, during the time relevant to this Complaint, "controlling persons" of Friedman's within the meaning of Section 20(a) of the Exchange Act and Section 15 of the Securities Act, and had the power and influence, which they exercised, to cause Friedman's to engage in the unlawful conduct complained of herein. By reason of their direct and substantial management positions and responsibilities and/or controlling ownership of Friedman's and its affiliates, the Individual Defendants and Control Person Defendants were able to and did, directly and/or indirectly, in whole or in material part, control the conduct of Friedman's and its affiliates' business and the information about those businesses contained in Friedman's public statements and filings with the SEC. Throughout the Class Period, the Individual Defendants and/or Control Person Defendants were provided with copies of, reviewed and approved, and/or signed press releases and other reports prior to or shortly after their issuance, and had the ability and opportunity to prevent their issuance or to cause them to be corrected. As a result, each of these Individual Defendants and/or Control Person Defendants was responsible for the accuracy of the public reports and releases detailed herein, and is therefore responsible and liable for the representations contained therein. The Individual Defendants knew or severely recklessly disregarded that adverse information had not been disclosed to, and was being concealed from, the public, and that the positive representations that were being made were materially false and misleading.

(b) It is appropriate to treat the Individual Defendants and Control Person Defendants as a group for pleading purposes and to presume that the false and misleading information conveyed in the Company's public filings, press releases and other publications as alleged herein are the collective actions of the Individual Defendants and Control Person Defendants identified above. Each Individual Defendant and/or Control Person Defendant, by virtue of their high level position within the Company and/or controlling ownership of Friedman's and its affiliates, directly participated in the management of the Company, was directly involved in the day-to-day operations of the Company at the highest levels, and was privy to confidential proprietary information concerning the Company and its operations, finances, financial condition, products and business prospects, as alleged herein. The Individual Defendants and/or Control Person Defendants were involved in drafting, producing, reviewing and/or disseminating the false and misleading statements alleged herein, were aware or were severely reckless in not being aware that the false and misleading statements were being issued regarding the Company, and approved or ratified these statements.

25. Each of the Individual Defendants and Friedman's knew or severely recklessly disregarded the facts that the misleading statements and omissions complained of herein would adversely affect the integrity of the market for the Company's securities, and would cause the price of the Company's common stock to become artificially inflated. Each of the Individual Defendants and Friedman's acted knowingly or in such a severely reckless manner as to constitute a fraud and deceit upon Lead Plaintiffs and the Class. Moreover, the Individual Defendants were also motivated to engage in and conceal the fraud alleged herein to inflate the value of Friedman's common stock in order to complete two public offerings during the Class Period. In the first offering, on February 6, 2002, Friedman's issued and sold to the investing public 3,750,000 shares of its Class A common stock, resulting in proceeds of $33 million. On September 19, 2003, Friedman's completed the second public offering of 3,100,000 shares of Class A common stock at $15.00 per share, which resulted in proceeds of $43.1 million. Among other things, the proceeds of the offerings were used to repay outstanding, undisclosed loans to the Individual Defendants and continue providing financial support to its affiliate, Crescent. The terms of the two secondary offerings would

have been negatively and materially affected had the market known the truth regarding Friedman's scheme of overstating accounts receivable and inventory and understating accounts payable, all of which artificially inflated the Company's revenues, income, earnings and stock price.

26. As direct participants in the wrongs complained of herein and/or as control persons of Friedman's. Friedman's, the Individual Defendants, the Control Person Defendants and Defendant E&Y are jointly and severally liable for the damages suffered by Lead Plaintiffs and other purchasers of Friedman's common stock during the Class Period for their violations of Sections 10(b) and 20(a) of the Exchange Act, and Rule 10b-5 promulgated thereunder. The Individual Defendants (except for Defendants Anderson, Cartoon and Mauro), the Director Defendants, Defendant E&Y and the Underwriter Defendants are jointly and severally liable for the damages suffered by the Section 11 Subclass during the Class Period for violations of Section 11 of the Securities Act. Friedman's, as issuer of the securities in connection with the Company's September 19, 2003 public offering, and the Underwriter Defendants (except for ABN AMRO Rothschild, LLC) are liable for the damages suffered by the Section 12(a)(2) Subclass during the Class Period for its violations of Section 12(a)(2) of the Securities Act. The Individual Defendants and Control Person Defendants are

jointly and severally liable for the damages suffered by the Class during the Class Period as control persons for violations of Sections 20(a) of the Exchange Act and 15 of the Securities Act.

CLASS ACTION ALLEGATIONS

27. Lead Plaintiffs bring this action as a class action pursuant to Federal Rules of Civil Procedure 23(a) and 23(b)(3) on behalf of themselves and a class consisting of all persons who purchased the common stock of Friedman's from January 26, 2000 through and including August 20, 2004. Lead Plaintiff Allan Bortel also brings this action on behalf of two subclasses: (i) Section 11 Subclass; and (ii) Section 12(a)(2) Subclass. Excluded from the Class and Subclasses are Defendants and other related non-parties herein, members of the immediate family of each of the Defendants and other related non-parties, any person, firm, trust, corporation, officer, director or other individual or entity in which any Defendant or other related non-party has a controlling interest or which is related to or affiliated with any of the Defendants or other related non-parties, and the legal representatives, agents, affiliates, heirs, successors-in-interest or assigns of any such excluded party or other related non-party.

28. The members of the Class are so numerous that joinder of all members is impracticable. Friedman's had over 18 million shares outstanding as

of November 12, 2003. The precise number of Class members is unknown to Lead Plaintiffs at this time but is believed to be in the thousands. In addition, the names and addresses of the Class members can be ascertained from the books and records of Friedman's or its transfer agent or the underwriters to the Company's public offerings during the Class Period. Notice can be provided to such record owners by a combination of published notice and first-class mail, using techniques and a form of notice similar to those customarily used in class actions arising under the federal securities laws.

29. Lead Plaintiffs will fairly and adequately represent and protect the interests of the members of the Class and Subclasses. Lead Plaintiffs have retained competent counsel experienced in class action litigation under the federal securities laws to further ensure such protection and intends to prosecute this action vigorously.

30. Lead Plaintiffs' claims are typical of the claims of the other members of the Class and Subclasses because Lead Plaintiffs' and all the Class members' and Subclass members' damages arise from and were caused by the same false and misleading representations and omissions made by or chargeable to Defendants. Lead Plaintiffs do not have any interests antagonistic to, or in conflict with, the Class or Subclasses.

31. A class action is superior to other available methods for the fair and efficient adjudication of this controversy. Since the damages suffered by individual Class and Subclass members may be relatively small, the expense and burden of individual litigation make it virtually impossible for the Class and Subclass members to seek redress for the wrongful conduct alleged. Lead Plaintiffs know of no difficulty that will be encountered in the management of this litigation that would preclude its maintenance as a class action.

32. Common questions of law and fact exist as to all members of the Class and Subclasses and predominate over any questions affecting individual members of the Class and Subclasses. Among the questions of law and fact common to the Class are:

a. Whether the federal securities laws were violated by Defendants' acts as alleged herein;

b. Whether the Registration Statement and Prospectus Supplements issued by Defendants to the investing public in connection with the Company's public offerings during the Class Period and Defendants' other public statements during the Class Period omitted and/or misrepresented material facts about Friedman's and its business; and

c. The extent of injuries sustained by members of the Class and Subclasses and the appropriate measure of damages.

I. THE FALSE AND MISLEADING STATEMENTS ISSUED DURING THE CLASS PERIOD

False Statements During Fiscal Year 2000

33. On January 26, 2000, Defendants issued a press release announcing "record" earnings for the first quarter of fiscal year 2000. The press release stated:

> For the first fiscal quarter ended January 1, 2000 net sales increased 21.0%, to a record $151.4 million from $125.1 million in the comparable period last year. Comparable store sales increased 6.2% during the first fiscal quarter versus 9.3% in the first fiscal quarter of the prior year. Diluted earnings per share for the first fiscal quarter increased 13.2%, to $1.03 per share, on 14,427,000 weighted average shares outstanding compared to a restated $0.91 per share, on 14,641,000 weighted average shares outstanding for the comparable period last year. At January 1, 2000, Friedman's had 564 stores in operation versus 469 at December 31, 1998, an increase of 20.3%
>
> Commenting on the results Bradley J. Stinn, Chief Executive Officer said "The December quarter's results reflect continued progress on a number of fronts. **We produced record sales and earnings.** We continued building the Friedman's brand, opening 33 new stores in existing markets, implementing new display systems in all stores and increasing advertising expenditures. **Our credit performance was excellent; all credit and cash flow statistics showed improvement. Additionally, our already strong balance sheet improved significantly with $8.6 million of debt outstanding at January 1, 2000, a ratio of debt to total capitalization of 4.0%. Lastly, Crescent Jewelers our west-coast affiliate, reported outstanding sales results that exceeded our expectations, culminating in a 20.7% increase in comparable store sales in the month of**

> **December. We believe these results confirm the decision to invest in Crescent.**
>
> As we go forward in fiscal 2000, we anticipate additional operational improvement. We will continue the implementation of our new merchandising programs throughout the next year (particularly addressing current gaps in our product assortments), continue our in-market power strip based expansion program and begin introduction of a cost reduction program to make operations more efficient."
>
> (emphasis added)[1]

34. On February 14, 2000, Defendants filed a quarterly report on Form 10-Q for the first fiscal quarter of 2000 ended January 1, 2000, signed by Defendant Suglia. The Form 10-Q repeated the financial results detailed in the first quarter earnings press release above, and falsely assured investors that:

> The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included.

35. The January 26, 2000 press release and Form 10-Q for the first fiscal quarter of 2000 contained materially false and misleading statements because the Company: (1) failed to write down an impairment for its investment in Crescent, as

[1] Unless otherwise noted, all emphases are added.

set forth in ¶¶143-150; (2) improperly recognized revenue, as set forth in ¶¶151-155; (3) understated its allowance for uncollectible accounts, as set forth in ¶¶156-172; (4) overstated inventory, as set forth in ¶¶173-176; and (5) was involved in a scheme, along with Crescent and Cosmopolitan, to defraud Capital Factors, which resulted in an understatement of Friedman's accounts payable, as stated in ¶¶177-184, all of which contravened the mandates of GAAP. Defendants knew or were severely reckless in not knowing that the January 26, 2000 press release and Form 10-Q for the first fiscal quarter of 2000 contained materially false and misleading statements as evidenced in ¶¶244-300 below.

36. On April 26, 2000, Defendants issued a press release announcing results for the second fiscal quarter of 2001. The Company once again reported a significant increase in financial growth. The press release, entitled "Friedman's Announces 31% Earnings per Share Increase" stated:

> For the second fiscal quarter ended April 1, 2000, net sales increased 30.3%, to $80.4 million from $61.7 million in the comparable period last year. Comparable store sales increased 10.7% during the second quarter versus an increase of 16.4% in the prior year. Earnings per share for the second quarter increased 31.3% to $0.21 per share, on 14,438,000 weighted average shares outstanding compared to $0.16 per share, on 14,668,000 weighted average shares outstanding for the comparable period last year. The Company opened 10 net new stores during the second quarter and at April 1, 2000, had 574 stores in operation, an increase of 20.3% from the prior year.

For the six months ended April 1, 2000, net sales increased 24.1%, to $231.8 million versus $186.8 million in the comparable period last year. Comparable store sales increased 7.6% for the six months ended April 1, 2000 compared to an 11.5% increase last year. Earnings per share for the six months ended April 1, 2000, increased 13.9% to $1.23 per share on 14,433,000 weighted average shares outstanding compared to $1.08 per share, on 14,645,000 weighted average shares outstanding for the comparable period last year.

Commenting on the results, Bradley J. Stinn, President and Chief Executive Officer of Friedman's, said, "We are very pleased with the operating results of the March Quarter. Sales volume was excellent. The double-digit increase in comparable store sales and a significant increase in new store sales productivity drove a solid 8.7% increase in net merchandise sales per store. The EBITDA margin improved slightly to 9.4% from 9.3% last year, resulting in a 31.5% increase in EBITDA for the March Quarter. **The balance sheet remains solid. Inventories per store declined, the credit reserve increased and debt to total capitalization improved.**

37. With respect to Crescent Jewelers, the press release stated:

Crescent Jewelers, our west-coast based affiliate, also produced solid results for the three months ending March 31, 2000. Comparable store sales during the March quarter for Crescent increased 13.4%. Crescent's EBITDA grew 38.4% during the three months ended March 31, 2000 to $2.6 million compared to $1.9 million for the same quarter in 1999.

38. On May 15, 2000, Defendants filed a quarterly report on Form 10-Q for the second fiscal quarter of 2000 ended April 1, 2000, signed by Defendant Suglia, repeating the financial results detailed above. The Form 10-Q also falsely

assured investors that the financial statements were prepared in accordance with generally accepted accounting principles ("GAAP").

39. The April 26, 2000 press release and Form 10-Q for the second quarter of 2000 contained materially false and misleading statements because the Company: (1) failed to write down an impairment for its investment in Crescent, as set forth in ¶¶143-150; (2) improperly recognized revenue, as set forth in ¶¶151-155; (3) understated its allowance for uncollectible accounts, as set forth in ¶¶156-172; (4) overstated inventory, as set forth in ¶¶173-176; and (5) was involved in a scheme, along with Crescent and Cosmopolitan, to defraud Capital Factors, which resulted in an understatement of Friedman's accounts payable, as stated in ¶¶177-184, all of which contravened the mandates of GAAP. Defendants knew or were severely reckless in not knowing that the April 26, 2000 press release and Form 10-Q for the second fiscal quarter of 2000 contained materially false and misleading statements as evidenced in ¶¶244-300 below.

40. On July 26, 2000, Defendants issued a press release entitled "Friedman's Announces 33% Earnings per Share Increase," announcing financial results for the third fiscal quarter of 2000. The press release stated:

> For the third fiscal quarter ended July 1, 2000, net sales increased 21.9%, to $81.1 million from $66.5 million in the comparable period last year. Comparable store sales increased 6.4% during the third

quarter. Earnings per share for the third quarter increased 33.3%, to $0.16 per share, on 14,453,000 weighted average shares outstanding compared to $0.12 per share, on 14,655,000 weighted average shares outstanding for the comparable period last year. The Company opened 25 net new stores during the third quarter and at July 1, 2000, had 599 stores in operation, an increase of 18.8% from the prior year.

For the nine months ended July 1, 2000, net sales increased 23.5%, to $312.9 million versus $253.3 million in the comparable period last year. Comparable store sales increased 7.3% for the nine months ended July 1, 2000 compared to a 9.8% increase for the comparable period in the prior year. Earnings per share for the nine months ended July 1, 2000, increased 16.8% to $1.39 per share on 14,439,000 weighted average shares outstanding compared to $1.19 per share, on 14,648,000 weighted average shares outstanding for the comparable period last year.

Commenting on the results, Bradley J. Stinn, President and Chief Executive Officer of Friedman's, said, **"We are pleased with the operating results of the June Quarter: sales volume was solid, while EBITDA increased 43.9%. EBITDA margin improved to 8.1% from 6.9% in the same period last year, driven by improvements in merchandise margins, net credit profitability and increased warranty revenues. Importantly, our balance sheet is in excellent condition with a debt to total capitalization ratio of 18.2%, positioning us well for continuing our power strip center based expansion program.** Our current expectations are to operate between 625 and 645 stores by Christmas 2000 with all of these new openings in existing markets."

41. On August 15, 2000, Defendants filed a quarterly report on Form 10-Q for the third fiscal quarter of 2000 ended July 1, 2000, signed by Defendant Suglia, repeating the financial results announced on July 26, 2000. The Form 10-Q

again assured investors that the financial statements were prepared in accordance with GAAP.

42. The July 26, 2000 press release and Form 10-Q for the third fiscal quarter of 2000 contained materially false and misleading statements because the Company: (1) failed to write down an impairment for its investment in Crescent, as set forth in ¶¶143-150; (2) improperly recognized revenue, as set forth in ¶¶151-155; (3) understated its allowance for uncollectible accounts, as set forth in ¶¶156-172; (4) overstated inventory, as set forth in ¶¶173-176; and (5) was involved in a scheme, along with Crescent and Cosmopolitan, to defraud Capital Factors, which resulted in an understatement of Friedman's accounts payable, as stated in ¶¶177-184, all of which contravened the mandates of GAAP. Defendants knew or were severely reckless in not knowing that the July 26, 2000 press release and Form 10-Q for the third fiscal quarter of 2000 contained materially false and misleading statements as evidenced in ¶¶244-300 below.

43. On November 21, 2000, Defendants issued a press release announcing "Record Fiscal 2000 EPS." The press release stated:

> For the fourth fiscal quarter ended September 30, 2000, net sales increased 16.9%, to a record $64.4 million from $55.1 million in the comparable period last year. Comparable store sales increased 4.9% during the fourth quarter. Loss per share for the fourth quarter decreased to $0.02 per share compared to a loss of $0.07 per share for

the comparable period last year. The Company opened 20 net new stores during the fourth quarter and at September 30, 2000, had 619 stores in operation, an increase of 16.6% from the prior year.

For the fiscal year ended September 30, 2000, net sales increased 22.3%, to a record $377.3 million from $308.4 million during the comparable period last year. Comparable store sales increased 6.9% for the fiscal year ended September 30, 2000. Net income for the fiscal year ended September 30, 2000 increased 19.6%, to $19.7 million from $16.5 million during the same period in 1999. Earnings per share for the fiscal year ended September 30, 2000 increased 20.4%, to a record $1.36 per share, on 14,445,000 weighted average shares outstanding, compared to a $1.13 per share, on 14,590,000 weighted average shares outstanding, for the comparable period last year.

Commenting on the results, Bradley J. Stinn, President and Chief Executive Officer of Friedman's, said, "We are very pleased with the financial results of the fourth fiscal quarter and our accomplishments overall in fiscal 2000. **During the fourth fiscal quarter, we delivered solid sales gains with an expanded merchandise gross margin and excellent expense control, resulting in a significantly improved operating margin. For the fiscal year ended September 30, we delivered record sales and earnings per share, improved our return on invested capital and shareholders' equity, and completed several major projects that, we believe, enhance our competitive position and will pay significant dividends in the future.**

44. With respect to Crescent Jewelers, Defendant Stinn stated:

"We are also very pleased with Crescent Jewelers' accomplishments for its fiscal year ended July 31, 2000. . . . **After completing a complex restructuring transaction in September 1999, Crescent delivered record sales results and an outstanding 38.9% increase in EBITDA. Importantly, coverage of third party interest expense for the fiscal year ended July 31, 2000 was 1.5x.**

> "As we look forward to the upcoming Christmas selling season, we are cautiously optimistic. Our optimism stems from the improvements we have made over the last year in our operations. **We have broadened and refined our product offerings and improved our merchandise replenishment processes.** In addition, store personnel are more comfortable executing our merchandise- specific in-case planograms, delivering a more appealing in-store presentation of product to the consumer. Furthermore, our advertising program for the November-December time period has been expanded, with greater frequency across virtually all media, including the advertising rollout of the e-commerce sites for our two brands. We are somewhat cautious in our outlook, however, due to the evidence over the last several months of slowing retail sales. Balancing these opposing thoughts, we are comfortable at present with an expectation of a 3% to 6% comparable store sales increase for the quarter ended December 30, 2000."

45. On December 28, 2000, Defendants filed the Company's annual report on Form 10-K for the 2000 fiscal year ended September 30, 2000 ("2000 Form 10-K"). The 2000 Form 10-K was signed by Defendants Stinn, Suglia, Cay, Cruickshank and Pickup. The 2000 Form 10-K stated with respect to credit operations:

> **Credit Operations**
>
> The Company's credit programs are an integral part of its business strategy. Approximately 53% of the Company's net merchandise sales in fiscal 2000 were generated by credit sales on the Company's proprietary credit cards.
>
> Opening a credit account allows Friedman's sales personnel to build relationships with customers that the Company believes engender customer loyalty and facilitate repeat purchases. To support this

strategy, the Company has developed a standardized scoring model and system for extending credit and collecting accounts receivable according to its strict credit disciplines.

46. The 2000 Form 10-K also falsely stated that:

Credit Extension. As a customer service and control measure, credit applications, references and credit bureau reports are evaluated by store personnel using the Company's proprietary computer-based credit scoring model.

The system allows the Store Partner to assess the risk level for each customer on a statistically objective basis and assists the Company in determining the appropriate credit limit as well as stipulations regarding the type of credit contract, suggested down payment and terms for which the customer is eligible.

Compliance with Company policies is reviewed and non-compliance addressed daily.

* * *

The Company's policy is generally to write-off in full any credit account receivable if no payments have been received for 120 days for stores opened prior to July 1, 1999, any credit accounts receivable if no payments have been received for 90 days for stores opened after June 30, 1999 and any other credit accounts receivable, regardless of payment history, if judged uncollectible (for example, in the event of fraud in the credit application or bankruptcy). The Company maintains an allowance for uncollectible accounts based in part on historical experience. As of September 30, 2000, the allowance was maintained at 10% of the accounts receivable balance. The Company expects that any downturn in general economic conditions in the markets in which it operates would adversely affect its collection of outstanding credit accounts receivable.

47. The 2000 Form 10-K also emphasized the Company's solid internal controls, stating:

> **Systems and Controls**
>
> The Company's management information systems utilize an IBM AS/400-based system. The management information systems use customized software which was specifically designed for the retail jewelry industry. The Company also utilizes a retail enterprise, state-of-the-art software system that significantly enhances the Company's ability to plan, manage, allocate, control and distribute its inventories. The systems also enable management to monitor the Company's credit operations. Supervisors and senior management can review and analyze credit activity by store, amount of sale, terms of sale or employees who approved the sale. The entire credit extension and collection process is automated and the system maintains all customer data to facilitate future credit transactions.

48. The November 21, 2000 press release and 2000 Form 10-K contained materially false and misleading statements because the Company: (1) failed to write down an impairment for its investment in Crescent, as set forth in ¶¶143-150; (2) improperly recognized revenue, as set forth in ¶¶151-155; (3) understated its allowance for uncollectible accounts, as set forth in ¶¶156-172; (4) overstated inventory, as set forth in ¶¶173-176; and (5) was involved in a scheme, along with Crescent and Cosmopolitan, to defraud Capital Factors, which resulted in an understatement of Friedman's accounts payable, as stated in ¶¶177-184, all of which contravened the mandates of GAAP. Defendants knew or were severely

reckless in not knowing that the November 21, 2000 press release and 2000 Form 10-K contained materially false and misleading statements as evidenced in ¶¶244-300 below.

Defendants' False Statements During Fiscal Year 2001

49. On January 24, 2001, Defendants issued a press release entitled "Friedman's Announces Record Christmas Quarter Earnings," announcing financial results for the first fiscal quarter of 2001. The press release stated:

> For the first fiscal quarter ended December 30, 2000 net sales increased 14.4%, to a record $ 173.3 million from $ 151.4 million in the comparable quarter last year. Comparable store sales increased 5.5% during the first fiscal quarter versus 6.2% in the first fiscal quarter of the prior year. Diluted earnings per share for the first fiscal quarter increased 16.5%, to a record $ 1.20 per share, on 14,473,000 weighted average shares outstanding compared to $ 1.03 per share, on 14,427,000 weighted average shares outstanding for the comparable quarter last year. The Company opened 12 net new stores during the first quarter and at December 30, 2000, had 631 stores in operation, an increase of 11.9% from the prior year.
>
> Commenting on the results, Bradley J. Stinn, President and Chief Executive Officer of Friedman's said, "We are very pleased with our performance during the Christmas season. Friedman's delivered a retail jewelry industry leading comparable store sales increase, along with an expanded merchandising margin, during a very difficult and promotional retail environment. Net income increased 16.9% as expense levels were on plan and overall financial disciplines were solid. We believe these financial results validate our long- term strategic positioning and our short-term tactical decisions for the just ended quarter.

> **"In addition, Crescent Jewelers posted solid sales results for the holiday season. Crescent delivered a 5.4% comparable store sales gain for the three months ended December 30, 2000 versus a 16.5% increase for the prior year period and a 7.5% increase in EBITDA. These results were led by the California group of stores, which delivered a 6.9% increase in comparable store sales for the quarter.**

50. Commenting on the Company's outlook, Defendant Stinn stated:

> "Looking forward, we anticipate the difficult trading conditions experienced in the Christmas season to continue for most of calendar 2001, with particularly difficult year-over-year comparisons for most retailers in the first calendar quarter. In light of this expectation, we plan to be aggressive operationally, using our comparative advantages to drive sales, and conservative financially, focusing on improving the productivity and profitability of our store portfolio."

51. On February 13, 2001, Defendants filed a quarterly report on Form 10-Q for the first fiscal quarter of 2001 ending December 30, 2000, signed by Defendant Suglia, repeating the financial results announced on January 24, 2001. The Form 10-Q falsely assured investors that the financial statements were prepared in accordance with GAAP.

52. The January 24, 2001 press release and Form 10-Q for the first fiscal quarter of 2001 contained materially false and misleading statements because the Company: (1) failed to write down an impairment for its investment in Crescent, as set forth in ¶¶143-150; (2) improperly recognized revenue, as set forth in ¶¶151-155; (3) understated its allowance for uncollectible accounts, as set forth in ¶¶156-

172; (4) overstated inventory, as set forth in ¶¶173-176; and (5) was involved in a scheme, along with Crescent and Cosmopolitan, to defraud Capital Factors, which resulted in an understatement of Friedman's accounts payable, as stated in ¶¶177-184, all of which contravened the mandates of GAAP. Defendants knew or were severely reckless in not knowing that the January 24, 2001 press release and Form 10-Q for the first fiscal quarter of 2001 contained materially false and misleading statements as evidenced in ¶¶244-300 below.

53. On April 25, 2001, Defendants issued a press release announcing second fiscal quarter 2001 financial results. The press release stated:

> For the second fiscal quarter ended March 31, 2001, net sales increased 9.5%, to $88.0 million from $80.4 million in the comparable period last year. Comparable store sales decreased 0.2% during the second quarter versus an increase of 10.7% for the comparable quarter last year. At March 31, 2001, the Company had 635 stores in operation, an increase of 10.6% from the prior year.
>
> Diluted earnings per share, before certain charges, for the second fiscal quarter were $0.21 per share versus $0.21 per share for the same quarter last fiscal year, excluding a $0.04 per share charge for store closings and a non- comparable loss related to the Company's Internet joint venture. The charges consisted of a $0.02 per share expense for the closure of seven stores and a $0.02 per share loss related to Internet operations. After these items, diluted earnings per share for the second quarter were $0.17 per share compared to $0.21 per share for the comparable period last year.
>
> For the six months ended March 31, 2001, net sales increased 12.7% to $261.3 million versus $231.8 million in the comparable period last

year. Comparable store sales increased 3.5% for the six months ended March 31, 2001 compared to a 7.6% increase last year. Diluted earnings per share for the six-month period increased 15.4% to $1.42 per share compared to $1.23 per share for the comparable period last year, excluding the store closing charge discussed above and the loss from the Company's Internet joint venture for the six month period ended March 31, 2001 of approximately $0.03 per share. After these items, diluted earnings per share for the year-to-date period increased 11.4% to $1.37 per share compared to $1.23 per share for the comparable period last year.

Commenting on the results, Bradley J. Stinn, President and Chief Executive Officer of both Friedman's and Crescent, said, "As expected, the March quarter proved to be a difficult trading period for the retail jewelry industry. **While not satisfied with flat comparable store sales, we believe these sales results will place Friedman's and Crescent at the favorable end of the range for comparable publicly traded retail jewelers.**"

Friedman's EBITDA profit margin during the quarter, excluding the impact of non-comparable charges, decreased slightly to 9.1% of net sales from 9.4% of net sales the prior year. The decrease in EBITDA margin is due to increased advertising expense: advertising expanded as a percent to sales by approximately 130 basis points as a result of an expanded marketing calendar and a modest amount of investment spending in certain geographic markets. All other expense categories on a combined basis declined as a percent to sales (approximately 100 basis points), reflecting excellent expense control during the quarter. **At March 31, 2001, Friedman's balance sheet was in solid shape with a 1.1% reduction in inventory per store and a reduction in the level of delinquent credit accounts.**

In addition, Friedman's closed seven stores during the quarter as part of a focus on improving the overall productivity of the store portfolio. While reducing earnings for the preceding quarter, this action is intended to improve return on investment in future periods.

54. On May 15, 2001, Defendants filed a quarterly report on Form 10-Q for the second fiscal quarter of 2001 ended March 31, 2001, signed by Defendant Suglia, repeating the financial results announced on April 25, 2001. The Form 10-Q again falsely assured investors that the financial statements were prepared in accordance with GAAP.

55. The April 25, 2001 press release and Form 10-Q for the second fiscal quarter of 2001 contained materially false and misleading statements because the Company: (1) failed to write down an impairment for its investment in Crescent, as set forth in ¶¶143-150; (2) improperly recognized revenue, as set forth in ¶¶151-155; (3) understated its allowance for uncollectible accounts, as set forth in ¶¶156-172; (4) overstated inventory, as set forth in ¶¶173-176; and (5) was involved in a scheme, along with Crescent and Cosmopolitan, to defraud Capital Factors, which resulted in an understatement of Friedman's accounts payable, as stated in ¶¶177-184, all of which contravened the mandates of GAAP. Defendants knew or were severely reckless in not knowing that the April 25, 2001 press release and Form 10-Q for the second fiscal quarter of 2001 contained materially false and misleading statements as evidenced in ¶¶244-300 below.

56. On July 25, 2001, Defendants issued a press release reporting third fiscal quarter 2001 operating results. The press release stated:

For the third fiscal quarter ended June 30, 2001, net sales increased 5.1%, to $85.2 million from $81.1 million in the comparable period last year. Comparable store sales increased 0.2% during the third quarter versus an increase of 6.4% for the comparable quarter last year. Diluted loss per share for the third fiscal quarter was $0.49 per share, on 14,517,000 weighted average shares outstanding compared to earnings per share of $0.16, on 14,453,000 weighted average shares outstanding for the comparable quarter last year. At June 30, 2001, the Company had 635 stores in operation, an increase of 6.0% from the prior year.

For the nine months ended June 30, 2001, net sales increased 10.7% to $346.5 million from $312.9 million in the comparable period last year. Comparable store sales increased 2.7% for the nine months ended June 30, 2001 compared to a 7.3% increase last year. Diluted earnings per share for the nine-month period decreased 36.7%, to $0.88 per share, on 14,495,000 weighted average shares outstanding compared to $1.39 per share, on 14,440,000 weighted average shares outstanding for the comparable period last year.

Commenting on the results, Bradley J. Stinn, President and Chief Executive Officer of Friedman's said, "Our operating results during the just ended quarter reflect two factors: (i) continued economic weakness, and (ii) a significant turning point in the development of the Friedman's brand.

Retail Environment

"While at the high end of performance in the retail jewelry industry, sales and gross margin were disappointing. **In addition, the rate of charge- off for credit accounts increased.** These primary factors, which reflect the difficult prevailing economic conditions, caused a modest operating loss from continuing operations.

57. Defendant Stinn characterized the quarter as a "new phase of growth," stating:

"Friedman's is now entering its next phase of growth focusing on increased earnings, not rapid growth. Over the last ten years, we laid the foundation for Friedman's to become one of the dominant retail jewelry brands in the United States. Through very rapid unit growth (opening approximately 650 stores in approximately 70 new markets) and making significant investments in the management team, systems and processes required to manage a national business and achieve

"The Friedman's brand is entering the next phase of its development, focusing on optimizing financial returns and positioning the business for accelerated earnings growth. We are reducing our planned rate of unit expansion to approximately 3% for the next two years to allow our store portfolio, organization and customer base to mature. Thereafter, we anticipate accelerating unit growth with new store openings in existing markets.

"In the context of transitioning to this new phase of growth, we undertook a comprehensive review of the business with the objective of eliminating low yielding assets and lines of business. As such, we established a reserve for closing or consolidating 23 stores and exited certain markets; we increased the allowance for doubtful accounts (including a reserve for closed stores) to achieve a significantly more conservative reserve position; we restructured our Internet joint venture writing off our entire fixed investment; and we reviewed inventory and other assets.

We believe these initiatives will pave the way for a significant increase in profitability in coming years.

"Average unit sales should increase significantly due to the lack of dilution from rapid growth. We have reached critical mass in substantially all markets and will start to benefit from marketing efficiencies.

"Expense ratios will improve as unit volume increases and the expense drag of new stores is reduced. **Credit and collection performance should improve as new customers represent a smaller percent of our total receivable base.**

> "All unit growth will be primarily in existing markets and, as a result, will further leverage expense ratios.
>
> "We believe the Friedman's brand is well positioned for the future in the retail jewelry industry and are highly optimistic about our prospects for fiscal 2002 and beyond."

58. On August 14, 2001, Defendants filed a quarterly report on Form 10-Q for the third fiscal quarter of 2001 ending June 30, 2001, signed by Defendant Suglia. The Form 10-Q repeated the financial results stated in the July 25, 2001 press release and falsely stated that the financial statements were prepared in accordance with GAAP.

59. The Form 10-Q also revealed that:

> In October 1994, we made $1.5 million in incentive loans to each of Mr. Stinn and Sterling B. Brinkley, our Chairman of the Board of Directors. The loans mature in 2004. We agreed to forgive principal and interest payments on these incentive loans if our Class A Common Stock reached certain prices. If we forgive principal and interest payments, we will incur compensation expense which reduces earnings. During 1995 and 1996, we incurred compensation expense of $3 million with respect to the incentive loans.

60. The July 25, 2001 press release and Form 10-Q for the third fiscal quarter of 2001 contained materially false and misleading statements because the Company: (1) failed to write down an impairment for its investment in Crescent, as set forth in ¶¶143-150; (2) improperly recognized revenue, as set forth in ¶¶151-155; (3) understated its allowance for uncollectible accounts, as set forth in ¶¶156-

172; (4) overstated inventory, as set forth in ¶¶173-176; and (5) was involved in a scheme, along with Crescent and Cosmopolitan, to defraud Capital Factors, which resulted in an understatement of Friedman's accounts payable, as stated in ¶¶177-184, all of which contravened the mandates of GAAP. Defendants knew or were severely reckless in not knowing that the July 25, 2001 press release and Form 10-Q for the third fiscal quarter of 2001 contained materially false and misleading statements as evidenced in ¶¶244-300 below.

61. On November 8, 2001, Defendants issued a press release announcing 2001 fiscal year end results. The press release stated:

> For the fourth fiscal quarter ended September 29, 2001, net sales increased 2.1%, to $65.7 million from $64.4 million during the comparable quarter last year. Comparable store sales decreased 1.5% during the fourth quarter. Diluted loss per share for the fourth fiscal quarter was $0.03 per share, on 14,518,000 weighted average shares outstanding, compared to a diluted loss per share of $0.02, on 14,462,000 weighted average shares outstanding, for the comparable quarter last year. At September 29, 2001, the Company had 643 stores in operation, an increase of 3.9% from the prior year.
>
> Commenting on the results, Bradley J. Stinn, Chairman and Chief Executive Officer of Friedman's said, "In light of the unprecedented and tragic events of September 11th, we are very pleased with the results of the just ended September quarter. Earnings declined slightly to a loss of $0.03 per share from a loss of $0.02 per share the prior year. The earnings decline is primarily attributable to the fall-off in sales registered post September 11th. Assuming that the quarter-to-date sales trend through September 10th (a 1.2% comparable store sales increase) could have been maintained through the end of

> September, earnings would have been at least $0.03 per share higher than reported, at approximately break-even levels. **Cost control was outstanding during the quarter as the gross margin to net sales ratio improved and operating expenses declined, on a per store basis, year over year.**
>
> "Given the uncertainty of prevailing economic conditions, however, we believe it is prudent to be cautious preparing for the upcoming Christmas selling season. As a result, we are planning operating expenses and inventory levels assuming flat comparable stores sales for the quarter and will operate 645 stores, an increase of only 2.2% compared to last year. **Notwithstanding this conservative posture on expenses and capital outlays, we are focused on driving sales by (i) improving merchandise assortments, matching each store's inventory and replenishment plan to its demographics and sales history; (ii) maintaining higher year-over-year in-stock rates; (iii) advertising more frequently across all media; and (iv) improving store level selling productivity.**
>
> "Looking forward into calendar 2002, we are highly optimistic about our prospects. Our competitive position within the retail jewelry industry is very strong and we have in place a deep and experienced management team, focusing on improving productivity. We are highly confident that our next phase of development will result in increased store level productivity and accelerated return on investment."

62. On December 28, 2001, Defendants filed an annual report on Form 10-K405 for fiscal year 2001 ending September 30, 2001 ("2001 Form 10-K"). The 2001 Form 10-K was signed by Defendants Stinn, Cay, Cruickshank, Pickup, Suglia, Brinkley and Parshall and repeated the financial results in the November 8, 2001 press release. The 2001 Form 10-K stated:

> CREDIT OPERATIONS
>
> Our credit programs are an integral part of our business strategy. We generated approximately 53% of our net merchandise sales in fiscal 2001 on our proprietary credit program . . .
>
> To support our store-level credit program, we have developed a standardized scoring model and system for extending credit and collecting accounts receivable according to our strict credit disciplines
>
> * * *
>
> Our policy is generally to write-off in full any credit accounts receivable if no payments have been received for 120 days and any other credit accounts receivable, regardless of payment history, if judged uncollectible (for example, in the event of fraud in the credit application). We maintain an allowance for uncollectible accounts based in part on historical experience.

63. With respect to systems and internal controls, the 2001 Form 10-K touted the efficacy of the Company's internal controls, stating:

> SYSTEMS AND CONTROLS
>
> Our management information systems utilize an IBM AS/400-based system and customized software that was specifically designed for the retail jewelry industry. The system allows supervisors and senior management to review and analyze sales and credit activity by store, amount of sale, terms of sale or employees who approved the sale. Our entire credit extension and collection process is automated and our system maintains all customer data to facilitate future credit transactions. Utilizing our management information systems, senior management and regional supervisors can monitor each store's and each employee's productivity and performance. The systems automatically provide a daily reconciliation of a store's transactions so that Store Partners can investigate discrepancies on a timely basis. Overall, the systems provide information that enables us to monitor

> merchandise trends and variances in performance so that we can improve the efficiency in our inventory and personnel management.
>
> In fiscal 1999, we embarked on a long-term strategy to upgrade information systems and financial controls. A retail enterprise software system was installed in fiscal 1999 that has enhanced our ability to plan, manage, allocate, control and distribute our inventories. Also in fiscal 1999, our general ledger system was upgraded. During fiscal 2001, internet connected personal computers were installed in every store improving communication between management, vendors and the stores resulting in efficiency improvements in the areas of credit, expense control and store promotions. We also implemented a new loss prevention software system in August 2001, which is tailored to a retail environment enhancing the tools available for loss prevention activities. We are in the process of installing a new credit system, which will enhance efficiency and control and a web based training program.
>
> In fiscal 2001, we began providing our affiliate Crescent Jewelers with merchandising, inventory management and replenishment systems, accounting and systems support and certain other back office processing services. To accomplish this, we integrated information technology systems with Crescent and as a result, Crescent's information systems and financial controls were upgraded.

64. The November 8, 2001 press release and 2001 Form 10-K contained materially false and misleading statements because the Company: (1) failed to write down an impairment for its investment in Crescent, as set forth in ¶¶143-150; (2) improperly recognized revenue, as set forth in ¶¶151-155; (3) understated its allowance for uncollectible accounts, as set forth in ¶¶156-172; (4) overstated inventory, as set forth in ¶¶173-176; and (5) was involved in a scheme, along with

Crescent and Cosmopolitan, to defraud Capital Factors, which resulted in an understatement of Friedman's accounts payable, as stated in ¶¶177-184, all of which contravened the mandates of GAAP. Defendants knew or were severely reckless in not knowing that the November 8, 2001 press release and 2001 Form 10-K contained materially false and misleading statements as evidenced in ¶¶244-300 below.

Defendants' False Statements During Fiscal Year 2002

65. On January 15, 2002, Defendants issued a press release, announcing financial results for the first fiscal quarter of 2002, entitled*:* "Friedman's Announces Record Earnings Results for the Holiday Quarter." The press release stated:

> For the first fiscal quarter ended December 29, 2001, net sales increased 5.6%, to $ 183.1 million from $ 173.4 million during the comparable period last year. Comparable store sales increased 3.1% during the first fiscal quarter versus an increase of 5.5% for the comparable quarter last year. Diluted earnings per share for the first fiscal quarter increased 5.0% to a record$ 1.26 per share, on 14,618,000 weighted average shares outstanding compared to$ 1.20 per share, on 14,473,000 weighted average shares outstanding for the comparable period last year. At December 29, 2001, the Company had 645 stores in operation, an increase of 2.2% from the prior year.
>
> Commenting on the results, Bradley J. Stinn, Chief Executive Officer of Friedman's said, "We are very pleased with our financial results for our first fiscal quarter. **We achieved record sales in the important Christmas selling season and delivered earnings per share that**

> **exceeded consensus analyst estimates. Our balance sheet is in excellent shape with inventories lower year-over-year and an increased net reserve position against our receivables."**

66. On February 12, 2002, Defendants filed a quarterly report on Form 10-Q for the first fiscal quarter of 2002 ending December 29, 2001, signed by Defendant Suglia. The Form 10-Q repeated the financial results stated in the January 15, 2002 press release and falsely assured investors that the financial statements were prepared in accordance with GAAP. With respect to the Company's provision for bad debts, the Form 10-Q stated in relevant part:

> Allowance for doubtful accounts of $27,077 at December 29, 2001, $21,518 at December 30, 2000, and $14,745 at September 29, 2001.
>
> The increase in the provision for bad debts as a percentage of net sales was primarily the result of an increase in the allowance for doubtful accounts at December 29, 2001 to 13.6% of accounts receivable as compared to 12.0% of accounts receivable at December 30, 2000. Our allowance for doubtful accounts are estimated each quarter based on historical experience, the composition of then outstanding balances, trends at specific stores and other relevant information. The application of this methodology for our first fiscal quarter resulted in an increase in the allowance primarily because a larger portion of our outstanding accounts receivable were more than 90 days past due. We do not believe that the increase in the allowance for doubtful accounts constitutes a material continuing trend.
>
> The increase in the provision for bad debts was primarily the result of an increase in the allowance for doubtful accounts as a percentage of gross accounts receivable. As a percentage of gross accounts receivable, the allowance for doubtful accounts was 12.2% at March 30, 2002 as compared to 9.7% at March 31, 2001 and was 13.6% at

> December 29, 2001 as compared to 12.0% at December 30, 2000. Application of our methodology for determining an appropriate allowance for doubtful accounts at March 30, 2002 resulted in an increase in the allowance primarily because a larger portion of our outstanding accounts receivable were more than 90 days past due. As discussed previously, **we do not believe that the increase in the allowance for doubtful accounts constitutes a material continuing trend.**

67. The January 15, 2002 press release and Form 10-Q for the first fiscal quarter of 2002 contained materially false and misleading statements because the Company: (1) failed to write down an impairment for its investment in Crescent, as set forth in ¶¶143-150; (2) improperly recognized revenue, as set forth in ¶¶151-155; (3) understated its allowance for uncollectible accounts, as set forth in ¶¶156-172; (4) overstated inventory, as set forth in ¶¶173-176; and (5) was involved in a scheme, along with Crescent and Cosmopolitan, to defraud Capital Factors, which resulted in an understatement of Friedman's accounts payable, as stated in ¶¶177-184, all of which contravened the mandates of GAAP. Defendants knew or were severely reckless in not knowing that the January 15, 2002 press release and Form 10-Q for the first fiscal quarter of 2002 contained false and misleading statements as evidenced in ¶¶244-300 below.

68. On April 18, 2002, Defendants issued a press release, announcing financial results for the second fiscal quarter of 2002. The press release stated:

> For the second fiscal quarter ended March 30, 2002, net sales increased 5.6%, to $93.0 million from $88.1 million in the comparable period last year. Comparable store sales increased 3.2% during the second quarter versus a decrease of 0.2% for the comparable quarter last year. At March 30, 2002, the Company had 648 stores in operation, an increase of 2.0% from the prior year.
>
> Net income for the second fiscal quarter increased 22.2%, to $3.0 million compared to $2.4 million for the comparable period last year. Diluted earnings per share for the second fiscal quarter increased 5.9%, to $0.18 per share compared to $0.17 per share for the comparable period last year on a larger share base. Weighted average shares outstanding increased 16.8% compared to the prior year, primarily due to the issuance of 4.1 million shares in a common stock offering completed February 11, 2002.
>
> Commenting on the results, Bradley J. Stinn, Chief Executive Officer of Friedman's said, **"The March quarter's results were very solid. We delivered a strong earnings increase with outstanding balance sheet and cash flow management. In addition, we completed several major projects during the quarter, which we believe will pay dividends as we go forward. We enhanced and built our management team, reorganized our store organization and introduced a new store-level credit collection process.**
>
> Looking forward to the remainder of calendar 2002, we feel comfortable with expectations for modest increases in sales and expect to continue to increase profitability through improved credit execution and tight expense control. We expect to be operating approximately 660 and 665 stores during the upcoming Christmas season."

69. On the same day, Defendants held a conference call for analysts and investors. During the call, Defendant Stinn stated:

> You know, the march quarters results were solid. We delivered a strong earnings increase with outstanding balance sheet and cash flow

management, particularly as Vic just went through on the credit side of the equation with a widening spread, both year over year and sequentially quarter to quarter in our credit reserves.

In addition, during the quarter, we completed several major projects which we believe will pay dividends as we go forward. We enhanced and built our management team. In particular we added a vice president of advertising, a new VP at human resources, and a new leader in our merchandising area. We reorganized our store organization and introduced a new store level credit and collection process to very good initial results.

Looking forward to the remainder of the calendar year, we feel comfortable with expectations for modest sales increases and expect to continue to increase profitability through improved credit execution and tight expense control. And lastly, we expect to be operating approximately 660 to 665 stores during this upcoming Christmas season. So from our store base now at 648, we'll open approximately 10 to 15 stores through the end of the calendar year.

70. On the same call, Defendant Suglia added:

I would like to review several of the key credit statistics.

First, our allowance for doubtful account at March 30th, 2002, was 12.2 percent, an increase of 250 basis points or 2.5 percent from the year ago period. Next, are delinquencies, 90 days or greater, past due, were 3.7 percent of gross receivables at March 30th, compared to 3.2 percent as of march 31st, 2001, an increase of 50 basis points from the year ago period. As a result, our net coverage over our 90 day delinquency file improved by 200 basis points or 2 percent from the year ago period.

Finally, our current accounts were 88.9 percent of gross receivables at March 30th compared to 88.8 percent of gross receivables at March 31st, 2001, an improvement of 10 basis points from the prior year. Summarizing, we continue to be aggressive in our charge offs, and

> we've increased our spread between delinquencies and the reserve for future charge offs.

71. On May 14, 2002, Defendants filed a quarterly report on Form 10-Q for the second fiscal quarter of 2002 ended March 30, 2002, signed by Defendant Suglia. The Form 10-Q repeated the financial results set forth in the April 18, 2002 press release and falsely stated that the financial statements were prepared in accordance with GAAP. With respect to the allowance for uncollectible accounts, the Form 10-Q stated:

> The allowance for doubtful accounts of $21,413 at March 30, 2002, $15,550 at March 31, 2001, and $14,745 at September 29, 2001.
>
> The increase as a percentage of net sales was primarily the result of increases in the provision for bad debts and other operating expenses, partially offset by an increase in receivable revenues. The increase in the provision for bad debts as a percentage of net sales was primarily the result of an increase in the allowance for doubtful accounts at March 30, 2002 to 12.2% of accounts receivable as compared to 9.7% of accounts receivable at March 31, 2001.
>
> The application of our methodology for determining the allowance for doubtful accounts, as discussed above, for our second fiscal quarter resulted in an increase in the allowance primarily because a larger portion of our outstanding accounts receivable were more than 90 days past due. At March 30, 2002, 3.7% of our accounts receivable were 90 days or more past due compared to 3.2% at March 31, 2001. We do not believe that the increase in the allowance for doubtful accounts constitutes a material continuing trend.

72. The April 18, 2002 press release and conference call and Form 10-Q for the second fiscal quarter of 2002 contained materially false and misleading

statements because the Company: (1) failed to write down an impairment for its investment in Crescent, as set forth in ¶¶143-150; (2) improperly recognized revenue, as set forth in ¶¶151-155; (3) understated its allowance for uncollectible accounts, as set forth in ¶¶156-172; (4) overstated inventory, as set forth in ¶¶173-176; and (5) was involved in a scheme, along with Crescent and Cosmopolitan, to defraud Capital Factors, which resulted in an understatement of Friedman's accounts payable, as stated in ¶¶177-184, all of which contravened the mandates of GAAP. Defendants knew or were severely reckless in not knowing that the April 18, 2002 press release and conference call and Form 10-Q for the second fiscal quarter of 2002 contained materially false and misleading statements as evidenced in ¶¶244-300 below.

73. On July 23, 2002, Defendants issued a press release, announcing earnings per share of $0.13 and other financial results for the third fiscal quarter of 2002. The press release stated:

> For the third fiscal quarter ended June 29, 2002, net sales increased 6.8%, to $91.0 million from $85.3 million in the comparable period Last year.
>
> Comparable store sales increased 4.0% during the third quarter versus an increase of 0.2% for the comparable quarter last year. At June 29, 2002, the Company had 650 stores in operation, an increase of 2.4% from the prior year. Net income for the third fiscal quarter increased to $2.0 million compared to a loss of $7.0 million for the comparable

period last year. Diluted earnings per share for the third fiscal quarter increased to $0.11 per share compared to a loss of $0.49 per share for the comparable period last year.

Weighted average shares outstanding increased 31.2% compared to the prior year, primarily due to the issuance of 4.1 million shares in a common stock offering completed February 11, 2002.

Friedman's also announced the signing of a commitment for a new $150 million senior credit facility and anticipates the signing of a commitment for a new $50 million senior credit facility for Crescent Jewelers, its west coast affiliate, this week. Both facilities are led and underwritten by Bank of America and CIT Group and by their terms eliminate Friedman's guarantee of Crescent's debt. Friedman's will continue its financial support of Crescent in the form of a direct investment. The final terms of the direct investment in Crescent by Friedman's will be approved by a committee of independent directors. Friedman's anticipates the closing of these transactions prior to the expiration of the current facilities.

Commenting on the results, **Bradley J. Stinn, Chief Executive Officer of Friedman's, said, "We are pleased with the operating and financial results detailed herein. Profits exceeded expectations on solid sales gains and improved expense levels. Also, our financial position has improved year-over-year. Asset turnover has accelerated and financial leverage has been reduced significantly**. The closing of our new credit facility will further improve our balance sheet, while soundly capitalizing Crescent to take advantage of its unit growth and other opportunities.

“Based on current business trends and the strength of our strategic positioning, we are comfortable with expectations of low single digit comparable store sales increases for the September quarter. For the upcoming Christmas season, we expect to be operating approximately 665 stores and are planning our merchandising and marketing programs based on an assumption of a low single digit comparable store sales increase.

> **"We are very pleased by the progress made this fiscal year-to-date in improving the daily execution of our business formula and enhancing our competitive position, while materially strengthening our financial position. We believe Friedman's is well positioned for continued improvement in fiscal 2003."**

74. On August 12, 2002, on article appeared in Women's Wear Daily entitled "Friedman's Reverses Year-Ago Loss." The article stated:

> NEW YORK--Higher sales and lower costs allowed Friedman's Inc. to return to profitability in the third quarter of fiscal 2002.
>
> For the three months ended June 29, the Savannah, Ga.-based jewelry retailer reported net income of $2 million, or 11 cents a diluted share. In last year's quarter the company posted a net loss of $7 million, or 49 cents. Earnings per share beat Wall Street estimates by a penny.
>
> Sales for the period grew 6.8 percent to $91 million from $85.3 million a year ago. Comparable-store sales likewise increased, gaining 4 percent during the quarter.
>
> Greater efficiency accrued to the bottom line as selling, general and administrative expenses declined 17.3 percent to $37.2 million from $44.9 million last year.
>
> **"We are pleased with the operating and financial results. Profits exceeded expectations on solid gains and improved expense levels," said chief executive officer Bradley Stinn in a statement, asserting that Friedman had succeeded at "improving the daily execution of our business formula and enhancing our competitive position, while materially strengthening our financial position."**
>
> Overall, for the nine months ended June 29, Friedman's reported earnings shot up 84.1 percent to $23.4 million, or $1.39 a share. That compares to last year's net income of $12.7 million, or 88 cents. Sales improved 5.9 percent to $367 million from $346.8 million a year ago as same-store sales increased 3.3 percent.

75. On August 13, 2002, Defendants filed a quarterly report on Form 10-Q for the third fiscal quarter of 2002 ended June 29, 2002, signed by Defendant Suglia. The report included the assurance detailed in the Form 10-Q for the first fiscal quarter of 2002 regarding Friedman's conservative write-off and accounting procedures. The Form 10-Q repeated the financial results as disclosed in the July 23, 2002 press release and falsely assured investors that the financial statements were prepared in accordance with GAAP. The Form 10-Q also provided the following information:

> We maintain an allowance for uncollectible accounts. We estimate the reserve each quarter based on historical experience, the composition of outstanding balances, trends at specific stores and other relevant information. The application of this methodology may result in increases or decreases in our provision for uncollectible accounts from quarter to quarter. Our policy is generally to write off in full any credit account receivable if no payments have been received for 120 days and any other credit accounts receivable, regardless of payment history, if judged uncollectible (for example, in the event of fraud in the credit application or bankruptcy).
>
> * * *
>
> Our senior management and our independent accountants have discussed each of the above accounting policies and the selection of the various accounting estimates used with the Audit Committee of our Board of Directors. The Audit Committee has reviewed the results of operations for the three months and nine months ended June 29, 2002.

76. The July 23, 2002 press release, statements in the August 12, 2002 article and the Form 10-Q for the third fiscal quarter of 2002 contained materially false and misleading statements because the Company: (1) failed to write down an impairment for its investment in Crescent, as set forth in ¶¶143-150; (2) improperly recognized revenue, as set forth in ¶¶151-155; (3) understated its allowance for uncollectible accounts, as set forth in ¶¶156-172; (4) overstated inventory, as set forth in ¶¶173-176; and (5) was involved in a scheme, along with Crescent and Cosmopolitan, to defraud Capital Factors, which resulted in an understatement of Friedman's accounts payable, as stated in ¶¶177-184, all of which contravened the mandates of GAAP. Defendants knew or were severely reckless in not knowing that the July 23, 2002 press release, statements in the August 12, 2002 article and the Form 10-Q for the third fiscal quarter of 2002 contained materially false and misleading statements as evidenced in ¶¶244-300 below.

77. On November 6, 2002, Defendants issued a press release announcing record 2002 net income and other results for the 2002 fiscal year. The press release stated:

> For the fourth fiscal quarter ended September 28, 2002, net sales increased 5.3%, to $69.2 million from $65.8 million during the comparable quarter last year. Comparable store sales increased 3.8% during the fourth quarter. Diluted loss per share for the fourth fiscal quarter was $0.01 per share compared to a diluted loss of $0.03 per

share for the comparable quarter last year. Weighted average shares outstanding increased 28.3%, to 18,620,000 for the fourth fiscal quarter compared to 14,518,000 for the comparable quarter last year.

For the fiscal year ended September 28, 2002, net sales increased 6.1%, to $436.1 million from $411.0 million during the comparable period last year. Comparable store sales increased 3.5% for the fiscal year just ended. Diluted earnings per share for the fiscal year increased 58.7%, to $1.34 per share compared to $0.84 per share for the comparable period last year. Weighted average shares outstanding increased 19.4%, to 17,347,000 for the fiscal year ended September 28, 2002 compared to 14,531,000 for the comparable period last year.

Commenting on the results, Bradley J. Stinn, Chairman and Chief Executive Officer of Friedman's said, "Fiscal 2002 was a very successful year. We achieved our earnings target, posting an 89% increase in net income despite unsettled economic conditions. In addition, we significantly strengthened our balance sheet with year-over-year debt reduction of $69 million. As part of this effort, we successfully restructured and refinanced our senior bank facility, eliminating the Crescent guarantee and solidly capitalizing Crescent with a direct investment. On the operations front, we streamlined our store organization and added depth to our senior management team. We also completed a comprehensive brand review that will enable us to improve the effectiveness of our marketing expenditures, resulting in increased awareness of the Friedman's brand, more customer traffic in our stores and deeper customer relationships.

"Based on current business trends and the strength of our strategic positioning, we are comfortable with expectations of a low single digit comparable store sales increase for the December holiday season, and are planning our merchandising and marketing programs based on this assumption.

"We are very pleased by the progress made in fiscal 2002 in improving the daily execution of our business formula, which has translated into increased profitability per dollar of sales, and,

> **furthermore, believe the Friedman's brand is well positioned for continued improvement in fiscal 2003."**

78. On December 20, 2002, Defendants issued the Company's annual report on Form 10-K for the year ended September 28, 2002 ("the 2002 Form 10-K"), signed by Defendants Stinn, Brinkley, Cay, Cruickshank, Parshall, Pickup and Suglia. The 2002 Form 10-K repeated the financial information contained in the November 6, 2002 press release. In the 2002 Form 10-K, the Company admitted the extensive and daily control that its directors and officers had over the financial operations of the Company:

> Senior Partners, Regional Vice Presidents and Division Vice Presidents interact on a daily basis with our senior management to review individual store performance. We believe that our store management structure enables senior management, Senior Partners, Regional Vice Presidents and Division Vice Presidents to focus on our daily operating disciplines and the needs of our target customers.

79. The 2002 Form 10-K also provided the following information:

> CREDIT OPERATIONS
>
> Our credit programs are an integral part of our business strategy. We generated approximately 53% of our net merchandise sales in fiscal 2002 through our proprietary credit program.
>
> * * *
>
> To support our store-level credit program, we have developed a standardized scoring model and system for extending credit and collecting accounts receivable according to our strict credit disciplines. We access credit bureau reports and process credit

> applications at each store, which provides our customers with convenient access to credit.
>
> * * *
>
> As part of our overall business strategy, we have maintained a strategic relationship with Crescent since 1996. As part of this relationship, we entered into agreements with Crescent under which we provide Crescent Jewelers with accounting and information technology support, along with certain other back office processing services. From September 1999 through August 2002, we provided credit enhancement for Crescent's credit facility. In partial consideration for the credit enhancement, we received a warrant to purchase 50% of Crescent's capital stock for $500,000, which remains outstanding. In connection with Crescent's new credit facility in August 2002, we continued our support in the form of a direct investment in Crescent totaling $85.0 million, consisting of $50.0 million of Series A preferred stock and $35.0 million of a senior subordinated note.
>
> * * *
>
> Accounts Receivable. Approximately 50% of our merchandise sales are made under installment contracts due in periodic payments over periods typically ranging from three to 24 months.

80. Also on December 20, 2002, Defendants Suglia and Stinn each signed certifications pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, which were subsequently filed as exhibits to the Company's 2002 Form 10-K and stated:

> 1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Act of 1934; and
>
> 2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

81. The November 6, 2002 press release, 2002 Form 10-K and the Sarbanes-Oxley certifications contained materially false and misleading statements because the Company: (1) failed to write down an impairment for its investment in Crescent, as set forth in ¶¶143-150; (2) improperly recognized revenue, as set forth in ¶¶151-155; (3) understated its allowance for uncollectible accounts, as set forth in ¶¶156-172; (4) overstated inventory, as set forth in ¶¶173-176; and (5) was involved in a scheme, along with Crescent and Cosmopolitan, to defraud Capital Factors, which resulted in an understatement of Friedman's accounts payable, as stated in ¶¶177-184, all of which contravened the mandates of GAAP. Defendants knew or were severely reckless in not knowing that the November 6, 2002 press release, 2002 Form 10-K and the Sarbanes-Oxley certifications contained materially false and misleading statements as evidenced in ¶¶244-300 below.

82. Defendants' false statements were accepted as true by investors and analysts. For example, a November 14, 2002 report by Dutton & Associates stated:

> J.M. Dutton & Associates continues research coverage of Friedman's Inc. (Nasdaq:FRDM) with a Buy rating and a 12-month $13.05 price target (recent price $8.71). The 6-page update report by J.M. Dutton analyst Paul J. Resnik, CFA, is available at www.jmdutton.com as well as from Zacks, First Call, Multex, Bloomberg, and other leading financial portals.

> Fourth quarter revenues and EPS of $69.2 million and ($0.01) and full fiscal year revenues and EPS of $436.1 million and $1.34 matched our expectations. Our estimates for fiscal 2003 of $462.2 million and$1.45 remain unchanged. **At a time when concerns about consumer credit delinquencies are growing, Friedman's continues to report favorable trends. The risk-adjusted yield (yield less charge-offs) on its credit portfolio rose in fiscal 2002 to 9.6% from 6.9% in the previous year.** Management remains "comfortable with expectations of a low single-digit comparable store sales increase in the December holiday season." This projection is in line with our estimated 3.0-3.5% increase. The Company expects to have approximately 663 stores open for the 2002 Christmas selling season vs. 650 at the end of September, 645 in the 2001 holiday season, and our previous estimate of 660.

83. On January 15, 2003, Defendants issued a press release announcing record sales and other financial results for the first fiscal quarter of 2003. The press release stated:

> Friedman's Announces Record Sales and Income
>
> For the first fiscal quarter ended December 28, 2002, net sales increased 9.2%, to $198.1 million from $181.4 million during the comparable period last year. Comparable store sales increased 6.9% during the first fiscal quarter versus an increase of 3.1% for the comparable quarter last year. Net income for the first fiscal quarter increased 15.5%, to a record $21.3 million compared to $18.4 million for the comparable quarter last year. Diluted earnings per share for the first fiscal quarter were $1.14 per share compared to $1.26 per share for the comparable quarter last year. Weighted average shares outstanding increased 28.2%, to 18,747,000 for the first fiscal quarter compared to 14,618,000 for the comparable quarter last year.
>
> **Commenting on the results, Bradley J. Stinn, Chief Executive Officer of Friedman's said, "We are very pleased with the**

> **financial results for the Christmas quarter, posting record sales and profits. Operating profit margins expanded as we continued to refine our product assortment to drive sales and improve the execution of our retailing model. At quarter end, our balance sheet was in excellent condition, with store-for-store inventories lower year- over-year by 2.5% and the currency of our receivable portfolio improved. In addition, our financial leverage has been reduced significantly. At December 28, 2002, the ratio of total debt to total capitalization was 19.7% versus 35.3% the prior year. We believe these results validate our long-term strategic positioning, as well as our short-term tactical decisions."**

84. An article on January 21, 2003 in Women's Wear Daily entitled "WWD Jewelry Should Be a Gem in 2003; jewelry retailers post increases" reported that:

> Friedman's, a Savannah, Ga.-based retailer with 662 stores, said for the first quarter ended Dec. 28, net income rose 15.8 percent to $21.3 million, or $1.14 a diluted share, handily beating Wall Street's consensus estimates of $1.10. Last year, the company reported earnings of $18.4 million, or $1.26. The drop in earnings per share is attributable to an increase in the number of outstanding shares. Net sales rose 9.2 percent to $198.1 million versus sales of $181.4 million in last year's quarter. Same-store sales rose 6.9 percent on top of an increase of 3.1 percent in the prior year.
>
> **"Operating profit margins expanded as we continued to refine our product assortment to drive sales and improve the execution of our retailing model," Bradley J. Stinn, chief executive officer of Friedman's, said in a statement. "At quarter end, our balance sheet was in excellent condition, with store-for-store inventories lower year-over-year by 2.5 percent and the currency of our receivable portfolio improved."**

85. On January 15, 2003, the Company conducted a conference call regarding financial results for the first fiscal quarter of 2003. One participant questioned the adequacy of the allowance for uncollectible accounts to which Defendants Suglia and Stinn responded as follows:

> VICTOR SUGLIA: You know, we . . . go through a very detailed process . . . of analyzing where our portfolio is . . . and we do that every month but obviously we pay particular attention at the end of the quarter. And we go through a methodology based on historical charge-offs by bucket, and, you know, what our expectations are. So the answer to your question, you know, it is a formulaic type of process we go through, but I feel comfortable with where we are. You know, as I mentioned when I read through the release, currency has improved, delinquencies are down, so where we are with respect to, you know, the allowance for doubtful accounts I feel reasonably comfortable, based on, you know, where we were on December 28th.
>
> BRADLEY J STINN: But, you know, at all times at the Christmas quarter, you know, we're estimating charge-offs for -- from the Christmas business, you know, that will play out over the next -- the next nine months, and I think what Vic is saying is based on everything that we look at, you know, we feel that our provision is -- you know, is proper. But it's significant -- the provision is significantly more than the charge-offs during the quarter because the volume is -- you know, is the highest quarter.

86. The investor pressed forward with a follow-up question, noting that the Company’s allowance for uncollectible accounts was decreasing during a period when it appeared that lower-end credit quality was deteriorating. In response, Defendant Stinn stated:

> I think in the data that we released yesterday as part of the conference that we were at, we showed a trailing 12-month risk-adjusted yield over the percentage on our receivables of profit, if you will, you know, income minus the charge-offs line, and that showed an increase. And, you know, rather than looking at it on a quarterly basis, we just look at the trailing 12 months. That showed an increase and it seems like it's getting better. I think, you know, there's a couple of reasons I would -- I would point out that we may be -- you know, looks like we're going kind of against the -- against the grain.
>
> Number one is just the fact that there's a maturity factor that is happening in our stores that will benefit the credit side of the business. It benefits the sales side but it will also benefit the credit side. And then secondly, on top of that, Doug and Stuart Clifford (ph), who is running the stores, and their teams, are really focusing on drilling down to every store and improving the collection efficiency through training, through intensity, and through regimentation, if you will, at store level. So those two things are driving it, and I think, you know, as -- what we should see as the portfolio matures is a continual getting better of our credit business.
>
> On February 11, 2003, Defendants filed a quarterly report on Form 10-Q for the first fiscal quarter of 2003 ended December 28, 2002, signed by Defendant Suglia. The Form 10-Q repeated the financial results stated in the January 15, 2003 press release and falsely stated that the financial statements were prepared in accordance with GAAP.

87. Also on February 11, 2003, Defendants Suglia and Stinn each signed certifications pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, which were subsequently filed as exhibits to the Company’s Form 10-Q for the first fiscal quarter of 2003 filed with the SEC on February 11, 2003 and stated:

> 1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

> 2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

88. The January 15, 2003 press release and conference call, article on January 21, 2003, Form 10-Q for the first fiscal quarter of 2003 and the Sarbanes-Oxley certifications contained materially false and misleading statements because the Company: (1) failed to write down an impairment for its investment in Crescent, as set forth in ¶¶143-150; (2) improperly recognized revenue, as set forth in ¶¶151-155; (3) understated its allowance for uncollectible accounts, as set forth in ¶¶156-172; (4) overstated inventory, as set forth in ¶¶173-176; and (5) was involved in a scheme, along with Crescent and Cosmopolitan, to defraud Capital Factors, which resulted in an understatement of Friedman's accounts payable, as stated in ¶¶177-184, all of which contravened the mandates of GAAP. Defendants knew or were severely reckless in not knowing that the January 15, 2003 press release and conference call, article on January 21, 2003, Form 10-Q for the first fiscal quarter of 2003 and the Sarbanes-Oxley certifications contained materially false and misleading statements as evidenced in ¶¶244-300 below.

89. On April 24, 2003, the Company issued a press release announcing financial results for the second fiscal quarter of 2003 ended March 29, 2003. The press release also announced the expected consolidation of its financial statements

with those of its affiliate, Crescent Jewelers Inc., at the end of fiscal 2003. With respect to Friedman's financial results for the second fiscal quarter of 2003, the Company stated:

> For the second fiscal quarter ended March 29, 2003, net sales increased 4.3% to $98.4 million from $94.3 million in the comparable period last year. Comparable store sales increased 1.4% during the second quarter versus an increase of 3.2% for the comparable quarter last year. At March 29, 2003, the Company had 659 stores in operation, an increase of 1.7% from the prior year. During the quarter, the Company opened 6 stores and closed 9, for a net decrease of 3 stores.
>
> Net income for the second fiscal quarter increased 6.9% to $3.2 million compared to $3.0 million for the comparable period last year. Diluted earnings per share for the second fiscal quarter decreased to $0.17 per share compared to $0.18 per share for the comparable period last year on a larger share base. Weighted average shares outstanding increased 11.9%, to 18,951,000 for the second fiscal quarter compared to 16,933,000 for the comparable quarter last year, primarily due to the issuance of 4.1 million shares in a common stock offering completed February 11, 2002.
>
> Commenting on the results, Bradley J. Stinn, Chief Executive Officer of Friedman's said, "Earnings for the quarter were slightly below our expectations due to lower than anticipated merchandise sales in the month of March. Comparable store sales increased 5.6% for the two-months ending February, with March comparable store sales negative. We believe the decline in merchandise sales in March was primarily due to external factors. **However, we did introduce certain enhanced credit and collection procedures during the month that, we believe, limited credit sales but are expected to result in enhanced credit profits and accelerated cash flow in the future. Expense and balance sheet controls were excellent during the quarter.**

> “Compared to the same period last year our store count showed a modest increase; we closed more stores than originally planned and had the opening of several newly constructed shopping centers delayed due to construction issues. Looking forward, we expect to have approximately 690 stores in operation by fiscal year end.”

The April 24, 2003 press release was attached to the Company’s Form 8-K filed with the SEC on April 29, 2003, signed by Defendant Suglia.

90. On May 12, 2003, Defendants filed a quarterly report on Form 10-Q for the second fiscal quarter of 2003 ended March 29, 2003, signed by Defendant Suglia. The Form 10-Q repeated the financial results from the April 24, 2003 press release and falsely assured investors that the financial statements were prepare in accordance with GAAP. The Form 10-Q also stated:

> **Controls and Procedures.**
>
> Under the supervision and with the participation of our management, including our principal executive officer and our principal financial officer, we concluded an evaluation of the effectiveness of our "disclosure controls and procedures" on May 8, 2003. Our evaluation tested controls and other procedures designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities and Exchange Act of 1934, as amended, is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. Based on this evaluation, our principal executive officer and principal financial officer concluded as of May 8, 2003, that the information required to be disclosed in our reports that we file or submit under the Securities Exchange Act is accumulated and communicated to management, including our principal executive

> officer and principal financial officer, as appropriate, in a manner that allows timely decisions regarding required disclosure.
>
> There were no significant changes in our disclosure controls and procedures or in other factors that could significantly affect these controls and procedures subsequent to May 8, 2003.

91. Also, on May 12, 2003, Defendants Suglia and Stinn each signed certifications pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, which were subsequently filed as exhibits to the Company's Form 10-Q for second fiscal quarter 2003 filed with the SEC on May 12, 2003, and stated:

> 1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
>
> 2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

92. The April 24, 2003 press release, Form 10-Q for the second fiscal quarter of 2003 and the Sarbanes-Oxley certifications contained materially false and misleading statements because the Company: (1) failed to write down an impairment for its investment in Crescent, as set forth in ¶¶143-150; (2) improperly recognized revenue, as set forth in ¶¶151-155; (3) understated its allowance for uncollectible accounts, as set forth in ¶¶156-172; (4) overstated inventory, as set forth in ¶¶173-176; and (5) was involved in a scheme, along with Crescent and Cosmopolitan, to defraud Capital Factors, which resulted in an understatement of

Friedman's accounts payable, as stated in ¶¶177-184, all of which contravened the mandates of GAAP. Defendants knew or were severely reckless in not knowing that the April 24, 2003 press release, Form 10-Q for the second fiscal quarter of 2003 and the Sarbanes-Oxley certifications contained materially false and misleading statements as evidenced in ¶¶244-300 below.

93. On July 23, 2003, the Company issued a press release announcing financial results for the third fiscal quarter of 2003. In addition, Friedman's released pro-forma consolidated results for the nine-month period ended June 28, 2003 pursuant to its previously announced financial statement consolidation with those of its affiliate, Crescent Jewelers Inc., which will be effected at the end of fiscal 2003. With respect to Friedman's financial results, the Company stated:

> For the third fiscal quarter ended June 28, 2003, net sales increased 6.5% to $97.0 million from $91.1 million in the comparable period last year. Comparable store sales increased 3.2% during the third quarter versus an increase of 4.0% for the comparable quarter last year. At June 28, 2003, the Company had 675 stores in operation, an increase of 3.8% from the prior year.
>
> Net income for the third fiscal quarter increased 20.8% to $2.4 million compared to $2.0 million for the comparable period last year. Diluted earnings per share for the third fiscal quarter increased 20.2% to $0.13 per share compared to $0.11 per share for the comparable period last year while weighted average shares outstanding increased 0.5%, to 19,142,000 for the third fiscal quarter compared to 19,050,000 for the comparable period last year.

Commenting on the results, Bradley J. Stinn, Chief Executive Officer of Friedman's said, "**The quarter's results reflect further improvement in the execution of our business model. Solid merchandising and outstanding expense control drove profitability, with earnings growth limited by continued softness in the consumer credit environment** and the later than planned opening of the quarter's new stores. Profit margins expanded as earnings increased by approximately 20% on a 6.5% increase in net sales.

"Looking forward to our fourth fiscal quarter, we are cautiously planning for low single digit comparable store sales, as the trend of relatively strong 'event' periods (i.e. Mother's Day, Valentine's Day) and soft 'non-event' months continues. We anticipate opening 27 new stores during the quarter and closing 2 for a net increase of 25 stores versus zero net store growth for the comparable year ago period. We anticipate operating over 700 Friedman stores in the upcoming Christmas season."

Victor M. Suglia, Senior Vice President and Chief Financial Officer, added, "Our fourth fiscal quarter is typically a break-even quarter due to the traditional seasonality of our business. For the upcoming fourth fiscal quarter ending September 27, 2003, we are comfortable with expectations of a range of a $0.02 to $0.04 loss per share versus last year's $0.01 per share fourth quarter loss. This expectation includes two non-comparable expenses totaling approximately $0.04 per share. These anticipated expenses consist of (i) an after-tax charge of approximately $220 thousand ($0.01 per share) related to the accelerated depreciation and other expenses associated with the move of the Company's headquarters into its new facility in Savannah, Georgia; and (ii) an estimated $600 thousand (non-cash) expense ($0.03 per share) related to a higher end-of-year reserve for uncollectible accounts compared to historical end-of-year reserves (estimated at 10.5% of accounts receivable versus the historical average of approximately 10.0%), based on current credit trends. Assuming this range for the fourth quarter, Friedman's earnings per

> share for the fiscal year ending September 27, 2003 would be a range of $1.38 to $1.40 per share."

94. With respect to the presentation of consolidated financial statements with Crescent, Friedman's stated that, "pursuant to the Company's April 24, 2003 announcement regarding the financial statement consolidation of Crescent Jewelers to take place effective with the issuance of its financial results as of September 27, 2003, Friedman's is providing herein unaudited pro-forma consolidated financial data in advance of the required implementation date." The July 23, 2003 press release was attached to the Company's Form 8-K filed with the SEC on July 24, 2003, signed by Defendant Suglia.

95. On August 11, 2003, the Company filed a quarterly report on Form 10-Q for the third fiscal quarter of 2003, signed by Defendant Suglia. The Form 10-Q repeated the financial results stated in the July 23, 2003 press release and falsely assured investors that the financial statements were prepared in accordance with GAAP. The Form 10-Q also revealed the following information:

> **Financial Support of Crescent Jewelers**. In connection with the credit facility, we restructured our financial support of Crescent Jewelers by terminating our guarantee of Crescent Jewelers' previous $112.5 million senior secured revolving credit facility and making a direct investment in Crescent Jewelers of $85.0 million. This investment consists of $50.0 million of series A preferred stock and a $35.0 million senior subordinated note. Based in part on our financial support of $85.0 million, on August 28, 2002, Crescent Jewelers

> replaced its previous $112.5 million senior secured revolving credit facility with a $50.0 million secured credit facility. We continue to hold a warrant that we received on September 15, 1999 to purchase 50% of the capital stock of Crescent Jewelers for an exercise price of $500,000. The warrant will expire on September 14, 2014.
>
> The investments in Crescent Jewelers were recorded on our balance sheet as a noncurrent asset and are currently carried at their face value. In accordance with Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities" ("FAS 115"), each quarter we are required to evaluate whether there has been an other than temporary decline in the value of the investment. Any other than temporary reduction in value would result in an immediate income statement charge, which would reduce our reported net income and our earnings per share. As a result of our evaluation for the quarter ended June 28, 2003, there has not been a decline in the value of our investment in Crescent Jewelers.

96. On August 8, 2003, Defendants Suglia and Stinn each signed certifications pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, which were subsequently filed as exhibits to the Company's Form 10-Q for the third fiscal quarter of 2003 and stated:

> 1. I have reviewed this Quarterly Report on Form 10-Q of Friedman's Inc. for the fiscal quarter ended June 28, 2003;
>
> 2. Based on my knowledge, ***this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading*** with respect to the period covered by this Report;
>
> 3. Based on my knowledge, the financial statements, and other financial information included in the report, ***fairly present in all material respects the financial condition results of operations***

and cash flows of the registrant as of, and for, the periods ***presented in this report***;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-145(e) and 15d-145(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

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

   b) Paragraph omitted in accordance with SEC transition instructions contained in SEC Release 34-4798;

   c) Evaluated the effectiveness of the registrant's disclosure controls and procedures presented in this report and presented in this Report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and

   d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.

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

> a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
>
> b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting. (Emphasis added)

97. The July 23, 2003 press release, Form 10-Q for the third fiscal quarter of 2003 and the Sarbanes-Oxley certifications contained materially false and misleading statements because the Company: (1) failed to write down an impairment for its investment in Crescent, as set forth in ¶¶143-150; (2) improperly recognized revenue, as set forth in ¶¶151-155; (3) understated its allowance for uncollectible accounts, as set forth in ¶¶156-172; (4) overstated inventory, as set forth in ¶¶173-176; and (5) was involved in a scheme, along with Crescent and Cosmopolitan, to defraud Capital Factors, which resulted in an understatement of Friedman's accounts payable, as stated in ¶¶177-184, all of which contravened the mandates of GAAP. Defendants knew or were severely reckless in not knowing that the July 23, 2003 press release, Form 10-Q for the third fiscal quarter of 2003 and the Sarbanes-Oxley certifications contained materially false and misleading statements as evidenced in ¶¶244-300 below.

II. THE TRUTH TRICKLES OUT AND THE FRAUD CONTINUES

98. Defendants' massive fraud began to unravel on September 12, 2003, when Friedman's issued a press release announcing that it had been contacted by the SEC, which had opened an informal inquiry into the lawsuit filed by Capital Factors, Inc. The Capital Factors complaint generally alleges that Friedman's and others, including Crescent, intentionally or negligently participated with Cosmopolitan in the misrepresentation of the balance of Cosmopolitan's accounts receivable, which induced Capital Factors to continue to advance funds to Cosmopolitan. The lawsuit also alleges that Friedman's and Crescent improperly made payments on accounts with Cosmopolitan directly to Cosmopolitan. As a result of the September 12, 2003 announcement, Friedman's stock price fell from a close of $16.04 per share on September 11, 2003, to a closing price of $14.34 by September 15, 2003, a drop of over 10% in the next two trading days.

99. Less than a month later, Friedman's announced on October 2, 2003, that the DOJ had notified the Company on September 29, 2003, that it was conducting an investigation into the Capital Factors lawsuit. The announcement that the DOJ was also conducting an investigation into the Capital Factors lawsuit caused the price of Friedman's stock to drop from its closing price of $14.00 on

October 1, 2003, to $12.66 by October 3, 2003, a drop of almost 10% in the next two trading days.

100. On October 23, 2003, Friedman's issued a press release and filed a corresponding Form 8-K signed by Defendant Suglia, announcing that the Company was rescheduling the release of its financial results for the fourth quarter and year ended September 27, 2003, originally scheduled for November 11, 2003. The Company further stated:

> The reason for the rescheduling is that the company's year-end closing process has been delayed due to the diversion of company resources necessary to fulfill information requests in connection with a previously announced investigation by the Department of Justice, a related informal inquiry by the Securities and Exchange Commission, and the Audit Committee investigation into the allegations asserted in the August 13, 2003, lawsuit filed by Capital Factors, Inc., a former factor of Cosmopolitan Gem Corporation, a former vendor of Friedman's, as well as other matters. These investigations and inquiries continue at the present time.
>
> As a result, the company will schedule the release of its forth quarter and year-end financial information at such time as the company and its auditors have completed the necessary work to certify the financial results. At this time, Friedman's does not anticipate a delay in the filing of its annual report on Form 10-K with the Securities and Exchange Commission for the 2003 fiscal year.

101. The October 23, 2003 press release and corresponding Form 8-K was materially false and misleading because it failed to disclose that it: (1) failed to write down an impairment for its investment in Crescent, as set forth in ¶¶143-150;

(2) improperly recognized revenue, as set forth in ¶¶151-155; (3) overstated inventory, as set forth in ¶¶173-176; and (4) was involved in a scheme, along with Crescent and Cosmopolitan, to defraud Capital Factors, which resulted in an understatement of Friedman's accounts payable, as stated in ¶¶177-184, all of which contravened the mandates of GAAP. Defendants knew or were severely reckless in not knowing that the October 23, 2003 press release contained materially false and misleading statements as evidenced in ¶244-300 below.

102. The market again reacted negatively to the news of the rescheduling of the Company's earning release by sending the price of Friedman's stock from a close of $11.95 per share on October 23, 2003 down to a closing price of $10.85 per share on October 24, 2003, a drop of over 9% in one day of trading.

103. Subsequently, on November 11, 2003, Friedman's issued a press release and filed a corresponding Form 8-K signed by Defendant Stinn, announcing that, on October 29, 2003, it was advised by the SEC that it was issuing a formal order of a private investigation with respect to the Company. The formal investigation expanded the topics from the earlier announced investigation, adding the topics of the Company's allowance for uncollectible accounts and other financial matters, and sought to determine whether Friedman's may have issued materially false and misleading disclosures under the Securities Act of 1933 and

Securities Exchange Act of 1934 and whether there were possible violations of the internal controls and books and records provisions under the Exchange Act, for the period January 1, 2000 through the present. The Company also announced that the previously reported investigation by the DOJ into the Capital Factors matter had also been expanded to include Friedman's allowance for uncollectible accounts and other financial matters.

104. The November 11, 2003 press release and Form 8-K also announced that, based on currently available information, the allowance for uncollectible accounts was expected to increase to be in the range of 14% to 17% of accounts receivable outstanding as of fiscal year end September 27, 2003, compared to the previously disclosed expectation of 10.5%. However, the Company disclosed that this 14% to 17% estimate was subject to further adjustment based upon completion of the Company's analysis and E&Y's audit. Assuming the 14% to 17% range, the Company would incur an additional non-cash charge (net of income tax) ranging from approximately $0.23 to $0.43 per share.

105. The Company further admitted that the increase in the allowance was "a result of the Company's experience that shows the related credit losses subsequently incurred have been higher than the estimates used to establish the allowance." The Company also disclosed that it had not yet determined what

portion, if any, of the increase would be recorded as a prior period adjustment. The Company further reported it was not in a position to provide guidance on the impact of the charge on Fiscal 2003 earnings. The Company also announced that its CFO, Defendant Suglia, was being placed on a "leave of absence."

106. The November 11, 2003 press release and corresponding Form 8-K were materially false and misleading because it failed to disclose that the Company: (1) failed to write down an impairment for its investment in Crescent, as set forth in ¶¶143-150; (2) improperly recognized revenue, as set forth in ¶¶151-155; (3) overstated inventory, as set forth in ¶¶173-176; and (4) was involved in a scheme, along with Crescent and Cosmopolitan, to defraud Capital Factors, which resulted in an understatement of Friedman's accounts payable, as stated in ¶¶177-184, all of which contravened the mandates of GAAP. Defendants knew or were severely reckless in not knowing that the November 11, 2003 press release and Form 8-K contained materially false and misleading statements as evidenced in ¶¶244-300 below.

107. The November 11, 2003 announcement caused the market to punish Friedman's stock. On November 11, 2003, the Company's stock closed at $11.99 per share. By the close of trading on the next day, November 12, 2003, the

Company's stock fell to $7.31 per share, a loss of over 39% of its value in a single day of trading.

108. The news continued to worsen. Less than one week later, on November 17, 2003, Friedman's issued a press release and filed a corresponding Form 8-K signed by Defendant Stinn, announcing that the Audit Committee working with Defendant E&Y "has determined that the Company's historical financial statements for at least the fiscal years 2000, 2001 and 2001 and for the first three quarters of fiscal year 2003 will be restated. Accordingly, these financial statements and the related public filings with the SEC should no longer be relied upon. Ernst & Young has informed the Company that it is withdrawing its audit opinions on the previously-filed annual financial statements . . . Based on the most recent information available, the Company now believes the allowance may exceed 17%." The Company also announced that it was reviewing the effects of these matters on its credit facility and that, "as a result of the restatement, the filing of its Form 10-K for the fiscal year ended September 27, 2003 may be delayed."

109. The market again reacted to the bad news, sending the Company's stock price from a close of $7.38 per share on November 17, 2003, to $6.04 per share on November 18, 2004, a drop of over 18% in a single day. By November

21, 2003 (four trading days later), Friedman's stock price closed at $5.08, a drop of over 31% from its closing price of $7.38 per share on November 17, 2003.

110. The Atlanta Journal-Constitution published an article entitled "Woes Mount at Friedman's Jewelry Retailer Faces Probes, Will Restate Earnings," on November 28, 2003 that discusses Friedman's restatement and accounting improprieties at great length. In the article, Paul Resnik, an analyst who covers Friedman's for J.M. Dutton & Associates stated that "[s]omething is definitely very wrong here," and that what was most surprising about the bad debt issue was that it surfaced less than two months after Friedman's sold 3.1 million shares of common stock. "When people do any offering, the numbers get looked at by auditors and lawyers" Resnick pointed out. "Why was this not discovered before?" Furthermore, Charles W. Mulford, Jr., Georgia Tech accounting professor and co-author of a book on spotting "creative accounting," stated that normally, "a bad debt adjustment is not handled with a restatement."

111. Then, a dizzying flurry of press releases and 8-Ks began regarding the Company's plethora of changes in management as the web of deceit started to untangle before the Company's eyes. First, on December 2, 2003, Friedman's announced that the Board elected Robert Cruickshank non-executive Chairman of the Company and appointed Defendant Cartoon Interim Financial Consultant. The

Company also announced that Mssrs. Cruickshank and Defendant Cartoon, along with Defendant Anderson, will form an Office of the Chairman that will oversee the day-to-day operations of the Company. The press release stated that Defendant Stinn resigned from the Company and the Board of Directors.

112. Six days later, on December 8, 2003, the Company issued a press release, announcing that Defendant Cartoon was elevated to the position of Chief Financial Officer of Friedman's. Approximately two weeks later, on December 23, 2003, Friedman's announced that Defendant Brinkley has resigned his positions as an executive officer and member of Friedman's Board of Directors. The press release stated, however, that Defendant Brinkley will assume the position of interim Chief Executive Officer of Crescent and continues to serve on Crescent's Board of Directors.

113. On December 29, 2003, Friedman's issued a press release and filed a corresponding Form 8-K signed by Defendant Cartoon, announcing a delay in filing of the 2003 Form 10-K due to the previously disclosed restatement, formal investigations by SEC and DOJ and the continuing audit committee investigation. The Company stated that it expected to file its 2003 Form 10-K by the end of February 2004, but expected to provide preliminary financial information for the restated periods and year ended September 27, 2003, prior to that date. Also, the

Company stated that, on January 27, 2004, it intended to announce sales results for first fiscal quarter ended December 27, 2003. Friedman's also announced that its lenders notified the Company that it was in default under certain provisions of its credit agreement.

114. On January 7, 2004, the Company announced "sales results for its first quarter ended December 27, 2003. Net sales for the quarter increased 6.3%, to $210.6 million compared to $198.1 million during the comparable period last year. Comparable store sales increased 2.7% during the quarter."

115. On February 27, 2004, Friedman's issued a press release:

> Friedman's Inc. . . . announced an estimated comparable store sales increase of 5.6% for February 2004 (which includes the important Valentine's Day results) over the same period in 2003. Comparable sales for the quarter to date ending February 22, 2003 increased an estimated 4.7% over the same period in 2003.
>
> Doug Anderson, President and Chief Operating Officer, commented, "We are pleased with our strong results for the Valentine's Day sales period. The Valentine's Day period has now produced two successive years of greater than 5% growth in comparable store sales."
>
> * * *
>
> Friedman's also announced it will close between 50 and 65 under-performing stores over the next six months. Doug Anderson added, "Like most retail chains, we continually review individual store performance. Although the cast majority of our 714 stores are performing well, a number are not meeting our financial expectations, and we have decided to close them in order to better position

> Friedman's for continued success. We are committed to improving profitability across our store base and maximizing the return on investment of our inventory. We have already opened 24 new stores this fiscal year, and currently plan to open an additional 21 during the balance of the fiscal year."

116. The Company also announced it would be unable to meet previously announced plan to file its 2003 Form 10-K by the end of February 2004. The Company attributed the delay to several factors, including: (1) "the extent of work involved in the preparation of restated historical financial statements for the fiscal years 2001 and 2002 and for the first three quarters of fiscal year 2003;" (2) completion of the audit of the financial statements by [Defendant] Ernst & Young . . .; and (3) "the previously disclosed ongoing investigations by the [SEC] and [DOJ]." The press release continued to state that Friedman's will file its restated financial statements with its annual report on Form 10-K promptly upon completion of the audit. Friedman's disclosed that it would not be able to file its quarterly report on Form 10-Q for the quarter ended December 27, 2003 until after filing the annual report on Form 10-K. With regard to the restatement of the financial statements, "the Company clarified that while the principal reason for the restatement was concern over the accounting for the allowance for doubtful accounts, in the process of preparing the restatement the Company has identified several other areas that will be adjusted including inventory, accounts payable and

accrued liabilities." The January 7, 2004 and February 27, 2004 press releases correspond to Friedman's filing of a Form 8-K on February 27, 2004, which was signed by Defendant Cartoon.

117. The January 7, 2004 and February 27, 2004 press releases and corresponding Form 8-K announcing increasing comparable store sales were materially false and misleading because Defendants failed to disclose that the Company was in such a precarious financial condition that unless it was able to negotiate a new credit facility that it would be unable to pay its vendors, which ultimately led the vendors to stop shipping inventory to Friedman's. Defendants knew or were severely reckless in not knowing that the January 7, 2004 and February 27, 2004 press releases and corresponding Form 8-K contained materially false and misleading statements as evidenced by Defendants' admission on August 5, 2004, as set forth in ¶133.

118. The news about Friedman's worsened. On March 15, 2004, Friedman's issued a press release and filed a corresponding Form 8-K signed by Defendant Cartoon, stating that the Company was informed by Crescent management on March 12, 2004 that Defendant E&Y had resigned as Crescent's auditors. In the same press release, the Company stated that it retained an outside appraisal firm to provide a fair value determination of Friedman's investment in

Crescent, which would be used to assist the Company in determining whether an impairment charge to that investment is warranted. The Company announced that it expects to "record a substantial impairment of its investment in Crescent in the Friedman's Inc. fiscal 2003 financial statements. Friedman's believes that financial information for Crescent previously included in Friedman's public filings should no longer be relied upon." Based upon the Company's announcement of even more bad news, the Company's stock price fell from a close of $6.51 per share on November 15, 2003, to close at $5.75 per share on March 16, 2004, a drop of over 11%.

119. The government investigations continued to escalate as demonstrated by Friedman's press release of March 24, 2004. Friedman's announced that, as it expected (but never publicly disclosed), it had received a "Wells Notice" from the staff of the Division of Enforcement of the SEC. The "Wells Notice" indicated that the SEC was recommending authorization of a federal court civil enforcement action against Friedman's, alleging that Friedman's violated certain provisions of the Securities and Exchange Acts. The "Wells Notice" also stated "that the [SEC] may seek a permanent injunction, disgorgement with prejudgment interest, civil money penalties and additional equitable relief."

120. On April 13, 2004, the Company announced the appointment of David B. Parshall to role of Audit Committee Chairman to replace Mark C. Pickup, who died unexpectedly the week before. Six days later, on April 19, 2004, the NASD issued a pre-suspension notice to Defendant Morgan Schiff for the firm's failure to file its annual audited report for the period ending December 31, 2003.

121. On April 29, 2004, Friedman's filed a Form 8-K, signed by Defendant Cartoon, stating that the Company's Board of Directors met and adopted numerous corporate governance resolutions including amendments, to by-laws regarding:

(a) audit committee;

(b) nominating/ corporate governance committee;

(c) compensation committee;

(d) payments to affiliates;

122. The Company also adopted other corporate governance resolutions, involving:

(a) nominating/corporate governance committee;

(b) audit committee;

(c) compensation committee;

(d) corporate governance guidelines;

(e) standards of conduct and ethics for directors, officers and employees;

(f) policy statement of Friedman's regarding insider trading;

(g) policy statement of Friedman's regarding securities trades by company personnel; and

(h) disclosure controls and procedures of Friedman's.

123. However, less than a week later, on May 5, 2004, Friedman's issued a press release and filed a Form 8-K signed by Defendant Anderson, announcing that the holder of all Class B common stock executed a consent to corporate action that: (i) amends and restates the bylaws of the Company; (ii) appoints Alan L. Stanzler, Thaddeus S. Jaroszewicz, Joseph D. McSweeney, Peggy J. Brockschmidt and Allan M. Edwards as Board directors; and (iii) removes John E. Cay, III as a director. The effect of this action was to rescind the amendments to by-laws passed on April 29, 2004. The Company also announced that CFO, Defendant Cartoon, resigned his position with the Company effective immediately.

124. The next day, on May 6, 2004, the Dow Jones News Service reported that the New York Stock Exchange halted trading in Friedman's stock due to recent announcements regarding Board actions and the trading was to remain halted while the NYSE evaluated Friedman's continued listing. At the time trading was halted, Friedman's stock price had fallen to $4.97 per share.

125. On May 10, 2004, Friedman's issued a press release, announcing that, on May 7, 2004, Stonzler and McSweeney resigned from Friedman's Board after serving for a total of two days on the Board.

126. The Dow Jones News Service, on May 11, 2004, reported that the NYSE has continued to halt trading on Friedman's stock and that Friedman's may review and appeal the determination. The next day, PR Newswire reported that Friedman's announced that the NYSE has made a determination to delist the Company's Class A common stock. Friedman's noted that, although the Company's stock is not eligible for NASD over-the-counter trading, market makers have made a market for the stock in the pink sheets. As soon as the Company's stock resumed trading in the pink sheets, it was again punished by the market. On May 12, 2004, Friedman's stock closed at $2.65 per share, down from its prior trading price of $4.97 per share when trading was halted, a drop of over 46% of its value in a single day of trading. One day later, on May 12, 2004, Defendant Morgan Schiff's membership in the NASD was suspended as a result of its failure to file audited financial statements.

127. On May 14, 2004, PR Newswire reported that Friedman's announced the appointment of two new directors to the Company's board by the holder of Class B Common stock: Norman Deep, Esq. and Sheldon Whitehouse, Esq.

Friedman's Board of Directors also elected Allen Edwards as Chairman of the Board replacing Cruickshank. The Company disclosed that Edwards is the President of Morgan Schiff and "controlled by the holder of the Class B common stock." The article also enumerated several revisions to the Company's by-laws, including: (1) amending the Audit and Compensation Committee Charters so that the Board of Directors may directly appoint members of the Audit and Compensation Committees without being required to first obtain the recommendations of the Nominating/Corporate Governance Committee; and (2) reconstituted its Audit, Nominating/Corporate Governance and Compensation Committees to consist of Messrs. Parshall, Deep and Whitehouse; and (3) designated Mr. Whitehouse as the Chairman of the Audit Committee.

128. On May 21, 2004, EZCorp., whose sole stockholder and financial adviser is Defendant Morgan Schiff, issued a press release and filed a Form 8-K announcing that it received a subpoena on May 14, 2004, from the SEC regarding documents related to Defendant Morgan Schiff. EZCorp. stated that it has determined that Friedman's and its affiliates are the subject of the SEC investigation. Between May 14, 2004, when EZCorp. was notified about the SEC subpoena, and May 21, 2004, when EZCorp. publicly disclosed the issuance of the subpoena, Defendant Cohen sold 73,000 shares at artificially inflated prices while

in possession of adverse non-public information. On the day of the public announcement the price of EZCorp. stock closed at $7.44 per share, down $2.35, or 24% in a single day.

129. On May 26, 2004, Friedman's issued a press release and filed a corresponding 8-K signed by Edwards, announcing that its Board of Directors has created a special litigation committee and retained Kroll Zolfo Cooper LLC as restructuring advisors to the Company. The Company also announced that it would not appeal the NYSE's May 11 decision to delist Friedman's Class A common stock. Furthermore, Friedman's stated that Cruickshank resigned from the Company's Board effective immediately.

130. The continuing saga of the ever changing management at Friedman's continued as the PR Newswire reported on June 22, 2004, that Friedman's announced Sam Cusano as new Chief Executive Officer of Friedman's and a member of the Company's Board of Directors. One week later, on June 29, 2004, Friedman's announced that Defendant Anderson had resigned as President and COO. Sam Cusano was to assume Defendant Anderson's role as President. On the same day, Friedman's announced that Steve Moore has been named Chief Administrative Officer, General Counsel and Secretary of the Company.

131. The news continued to get worse for Friedman's as the SEC News Digest reported on June 30, 2004, that an order has been issued granting the NYSE's application seeking to strike from listing and registration Friedman's Class A common stock, effective June 30, 2004. Thus, the shares held by the investing public and purchased by Plaintiffs and the Class during the Class Period are no longer registered. Through May and June 2004, Friedman's stock continued to fall. By June 30, 2004, Friedman's stock closed at $3.17 per share.

132. On July 13, 2004, Friedman's issued a press release announcing that Jamie King had been elected as Director and its third Audit Committee Chairperson since April. In addition, the Company announced Steve Long resigned as Senior Vice President "to pursue unspecified other interests."

133. On August 5, 2004, an article from Hoover's Company Basic Records stated that Friedman's provides accounting and other management services to Crescent and has indicated that it may buy the smaller firm. On the same day, an article in PR Newswire reported that Friedman's announced that it has entered into a commitment letter with Farallon Capital Management, LLC, an affiliate of one of Friedman's credit facilities to provide $25 - $30 million in financing. The article also states that "[t]he Company has deferred most current payments to vendors over the last sixty days and many key vendors have reduced, delayed or suspended

merchandise shipments to the Company during that time." Friedman's also announced that Peggy Brockschmidt resigned from the Company's Board of Directors. As a result of this latest revelation, the Company's stock price got pounded again. On August 4, 2004, Friedman's stock closed at $3.71 per share. By the end of the next trading day, August 5, 2004, the stock closed at $2.28 per share, a loss of over 38% in value in one day.

134. On August 12, 2004, Dow Jones News Service reported that Crescent announced it filed for voluntary Chapter 11 bankruptcy protection. Crescent stated that it intends to use the Chapter 11 process to restructure the debt it has incurred during the past five years.

135. On August 20, 2004, Friedman's filed a press release, announcing that it had reached an interim foreclosure agreement with the Company's current lenders subject to the Company's ability to enter into mutually acceptable vendor support agreements. The Company's lenders also agreed to forbear on the existing default until August 31, 2004. Additionally, the Company stated that Ted Jaroszewicz resigned as member of its Board of Directors. By the close of trading on August 20, 2004, the Company's stock had fallen to $0.78 per share, a far cry from its Class Period high of $17.50 on September 3, 2003, a loss in value of over 95% in less than one year.

136. The whole truth is not yet known and will not be publicly revealed until Friedman's issues its restated financial statements for fiscal years 2000-2002 and the first three quarters of 2003; and results for fiscal years 2003 and 2004. Lead Plaintiffs may seek leave to amend once those results are announced.

III. GAAP VIOLATIONS

137. At all relevant times during the Class Period, Defendants represented that Friedman's financial statements when issued were prepared in conformity with GAAP, which are recognized by the accounting profession and the SEC as the uniform rules, conventions and procedures necessary to define accepted accounting practice at a particular time. However, in order to artificially inflate the price of Friedman's stock, Defendants used improper accounting practices in violation of GAAP and SEC reporting requirements to falsely inflate Friedman's assets, net worth, revenues, earnings and earnings per share and understate its liabilities during the Class Period. As a result of Defendants' accounting manipulations, the SEC is conducting a formal investigation and has issued a "Wells Notice," indicating that the SEC may institute a civil proceeding against the Company. Additionally, the DOJ is conducting its own investigation into Friedman's financial shenanigans. Friedman's has already admitted that it will be restating its financial statements for fiscal years 2000-2002, and the first three quarters for 2003.

138. Friedman's materially false and misleading financial statements resulted from a series of deliberate senior management decisions designed to conceal the truth regarding Friedman's actual operating results. E&Y, the long time auditors of both Friedman's and Crescent, knew or were severely reckless in not knowing of the accounting manipulations. As a result of the massive and egregious nature of the accounting fraud, E&Y withdrew its audit opinions for the 2000-2002 audits, which is an extremely rare event even in circumstances, such as exist here, where the Company has announced a restatement of its financial statements. Additionally, E&Y has resigned as the auditor for Crescent and Friedman's has admitted that Crescent's financial information appearing in Friedman's SEC filings should also not be relied upon.

139. Specifically, as discussed below, Defendants caused the Company to violate GAAP by:

(a) Failing to properly and timely write-down the Company's investment in Crescent;

(b) Improperly recognizing revenue;

(c) Failing to adequately set the allowance for uncollectible accounts;

(d) Failing to write down excess and obsolete inventory; and

(e) Understating accounts payable.

140. The magnitude of the specific amounts by which Friedman's financial statements were materially misstated is not yet known as the Company and its auditor, E&Y, continue to struggle to restate Friedman's financial results. In fact, Friedman's last publicly filed financial statements were filed with the SEC on or about August 11, 2003, more than one year ago. Additionally, Crescent has filed for Chapter 11 bankruptcy and the outcome of this bankruptcy, and therefore the ultimate effect on Friedman's, remains unclear. However, Friedman's has already admitted that its allowance for uncollectible accounts, investment in Crescent, inventory, accounts payable and accrued liabilities will all have to be adjusted.

141. GAAP are those principles recognized by the accounting profession as the conventions, rules, and procedures necessary to define accepted accounting practices at a particular time. As set forth in Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Concepts ("Concepts Statement") No. 1 (November 1978), one of the fundamental objectives of financial reporting is that it provide accurate and reliable information concerning an entity's financial performance during the period being presented. Concepts Statement No. 1, paragraph 42, states:

> Financial reporting should provide information about an enterprise's financial performance during a period. Investors and creditors often use information about the past to help in assessing the prospects of an

> enterprise. Thus, although investment and credit decisions reflect investors' and creditors' expectations about future enterprise performance, those expectations are commonly based at least partly on evaluations of past enterprise performance.

142. As set forth in SEC Rule 4-01(a) of SEC Regulation S-X, "[f]inancial statements filed with the [SEC] which are not prepared in accordance with [GAAP] will be presumed to be misleading or inaccurate." 17 C.F.R. § 210.4-01(a)(1). Management is responsible for preparing financial statements that conform with GAAP. As noted by the AICPA professional standards:

> financial statements are management's responsibility . . . . [M]anagement is responsible for adopting sound accounting policies and for establishing and maintaining internal control that will, among other things, record, process, summarize, and report transactions (as well as events and conditions) consistent with management's assertions embodied in the financial statements. The entity's transactions and the related assets, liabilities and equity are within the direct knowledge and control of management . . . . Thus, the fair presentation of financial statements in conformity with Generally Accepted Accounting Principles is an implicit and integral part of management's responsibility.

Failure to Write Down the Crescent Investment

143. In Friedman's 2001 Form 10-K, the Company stated that it and Crescent are affiliated through common controlling ownership and have certain common officers and directors. Friedman's disclosed that, in connection with Crescent's 1999 revolving syndicated bank facility, the Company agreed to

provide certain credit enhancements, including the support of $60 million of the Company's eligible receivables and inventories, and to guarantee Crescent's obligations to the banks that amounted to $108 million at September 29, 2001. In consideration for these enhancements and guarantees, Crescent was obligated to pay Friedman's a quarterly fee equal to 2% per annum of outstanding borrowings and Friedman's was issued a warrant to acquire 50% of Crescent's capital stock for nominal consideration.

144. The 2001 Form 10-K went on to state that Friedman's is actively assisting Crescent to pursue financing alternatives to replace Crescent's bank facility. Based on discussions with lenders and typical lending criteria, Friedman's anticipated that Crescent would restructure or replace its revolving credit facility by March 31, 2002. In connection with this anticipated refinancing, the Company believed that a portion of Crescent's capital requirement would be satisfied by financial support of up to $112.5 million from Friedman's. Management believed that this financial support would be in the form of a continuation of the guarantee, a direct investment in equity or debt securities or some other form of financial support. The Company was considering several financing alternatives of its own to facilitate such financial support, including a refinancing or restructuring of the Company's credit facility.

145. Friedman's also stated that, in management's opinion, the asset associated with the investment in Crescent was fully recoverable based on Crescent's cash flows and the estimated fair value of a corresponding investment in Crescent. Such estimated fair value was determined under an investment value methodology based on the Company's warrant to purchase 50% of Crescent's capital stock and Friedman's acquisition strategy.

146. In Friedman's 2002 Form 10-K, the Company revealed that, in connection with the refinancing of Crescent's credit facility in August 2002, Friedman's restructured its financial support of Crescent by terminating its guarantee of Crescent's previous $112.5 million senior secured revolving credit facility and making a direct investment in Crescent of $85 million. The investment consists of $50 million of Series A preferred stock and $35 million of a senior subordinated note. Based in part on Friedman's financial support of $85 million, on August 28, 2002, Crescent replaced its previous $112.5 million senior secured revolving credit facility with a $50 million secured credit facility. Friedman's continues to hold a warrant to purchase 50% of Crescent's capital stock for an exercise price of $500,000 that was received in consideration of the guarantee of Crescent's previous credit facility on September 15, 1999.

147. Friedman's also stated in its 2002 Form 10-K, with respect to the fair values of Friedman's financial instruments, that the reported amounts in the balance sheets at September 28, 2002 and September 29, 2001, for its investment in Crescent is due to Friedman's recent investment in Crescent.

148. At all relevant times, Friedman's disclosed that its investment in Crescent was recorded at fair value, applying Statement of Financial Accounting Standards No. 115 ("FAS115"), "Accounting for Certain Investments in Debt and Equity Securities," which provides in pertinent part:

> **[T]his Statement establishes standards of financial accounting and reporting for investments in equity securities that have readily determinable fair values and for all investments in debt securities.**
>
> * * *
>
> 16. For individual securities classified as either available-for-sale or held-to-maturity, an enterprise shall determine whether a decline in fair value below the amortized cost basis is other than temporary. For example, if it is probable that the investor will be unable to collect all amounts due according to the contractual terms of a debt security not impaired at acquisition, an other-than-temporary impairment shall be considered to have occurred. If the decline in fair value is judged to be other than temporary, the cost basis of the individual security shall be written down to fair value as a new cost basis and the amount of the write-down shall be included in earnings (that is, accounted for as a realized loss). The new cost basis shall not be changed for subsequent recoveries in fair value.

149. However, in contravention of FAS 115, Defendants knew or severely recklessly disregarded that a write-down of Friedman's investment in Crescent should have occurred as evidenced by the following:

(1) the lack of financial controls at Crescent that rendered Crescent's financial data grossly misstated;

(2) the interrelated management of Friedman's and Crescent, coupled with E&Y as the auditor for both companies;

(3) Crescent possessed negative net worth that grew to a staggering ($28) million as of September 2003;

(4) Crescent violated certain debt covenants of its credit agreement as disclosed in Friedman's 2001 Form 10-K;

(5) Friedman's was not receiving its interest payments on the subordinated debt and dividend payments on preferred stock in Crescent; and

(6) Crescent possessed a negative cash flow from operations.

150. Friedman's own public disclosures indicate that Defendants possessed knowledge or severe recklessness that Friedman's investment in Crescent should have been written down. The Company made a partial disclosure on March 15, 2004, in its press release and corresponding Form 8-K signed by Defendant Cartoon, that, in connection with the completion of the audit of Friedman's fiscal 2003 financial statements, the Company retained an outside appraisal firm to provide a conclusion on the fair value of Crescent to be used to assist Friedman's

in determining whether an impairment charge to that investment is warranted. Friedman's expects to "record a substantial impairment of its investment in Crescent in the Friedman's Inc. fiscal 2003 financial statements. Friedman's believes that financial information for Crescent previously included in Friedman's public filings should no longer be relied upon." In the same press release, Friedman's stated that it has contractual arrangements with Crescent under which Friedman's provides Crescent with, *inter alia*, accounting and information technology support. On August 12, 2004, Crescent filed for Chapter 11 bankruptcy protection.

Improper Revenue Recognition

151. Friedman's revenue recognition policy is set forth in the Company's 2002 Form 10-K, which states that revenue related to merchandise sales is recognized at the time of sale, reduced by a provision for returns. The returns provision is estimated principally based on prior year return rates. However, Friedman's actions as set forth below violated its own stated policy and contravened Accounting Concepts Number 5 ("CON 5") paragraph 83, which provides in pertinent part that:

> [r]evenues and gains generally are not recognized until realized or realizable. Revenues and gains are realized when products (goods or services), merchandise, or other assets are exchanged for cash or

> claims to cash. Revenues and gains are realizable when related assets received or held are readily convertible to known amounts of cash or claims to cash.

152. Defendants knew or were severely reckless in not knowing that revenue was improperly recognized as evidenced by the plethora of meetings at which the Company's financial condition were discussed and the internal reports they received and upon which they had access. Revenue was improperly recognized for at least two reasons: (1) Defendants knew or were severely reckless in not knowing that, at the time of the sale, the Company would not be able to collect the receivable associated with the sale; and (2) Defendants knew or were severely reckless in not knowing that they would not be able to realize the value associated with the inventory that was received in "trade" in association with the sale.

153. With respect to the uncollectibility of the receivable associated with the sale, a former Regional Partner, employed by Friedman's from September 1999 to July 2004, stated that "Friedman's is in the business of making money on credit through jewelry. Friedman's would give credit to anyone. Depending on what time of day it was, if the Store had not reached its daily goal of comparable sales, credit was approved for anyone who wanted it, just so our daily goal was met."

154. Friedman's also disclosed on November 17, 2003, that it would be increasing its allowance for uncollectible accounts from 10.5% to at least 17%, and that prior periods adjustments in connection with the Company's allowance for uncollectible accounts would also be forthcoming. The dramatic increase in the amount of charge-offs and the fact that Friedman's was extending credit to persons of questionable credit quality, which ultimately led to the increase in the allowance for uncollectible accounts, evidences that Defendants knew or were severely reckless in not knowing that the revenue associated with these charge-offs should not have been recognized.

155. In addition to sales made on credit, the Defendants caused Friedman's to improperly recognize revenue in another manner. According to a former Vice President of Operations ("V.P. of Operations"), employed by Friedman's approximately ten years until departing from the Company in July 2004, the Company devised a scheme by which the Company would fictitiously overstate its inventory. Friedman's created a policy whereby trade-in credit would be offered to customers on the condition that the new purchase doubled the price of the trade. For example, a $2000 purchase could be made upon a payment of $1000 and trading in jewelry valued at $1000. As set forth below, the value of the trade-in inventory was for far less than the value reported as the trade in part of the sale.

This resulted in improper revenue recognition and inflated inventory values to the extent of the over-valuation of the trade-in inventory.

Allowance for Uncollectible Accounts

156. Friedman's stated in its 2001 and 2002 Form 10-K's that the allowance for uncollectible accounts is estimated based on historical experience, the composition of outstanding balances, credit experience trends and other relevant information. The Form 10-K's go on to state that Friedman's policy is to write-off in full any credit account receivable if no payments have been received for 120 days and any other credit accounts receivable, regardless of payment history, if judged uncollectible (for example, in the event of fraud in the credit application or bankruptcy).

157. Friedman's actions in failing to properly set an allowance for uncollectible accounts contravened Statement of Financial Accounting Standards 5 ("FASB 5"), which provides in pertinent part:

> 1. For the purpose of this Statement, a contingency is defined as an existing condition, situation, or set of circumstances involving uncertainty as to possible . . . loss (hereinafter a "loss contingency") to an enterprise that will ultimately be resolved when one or more future events occur or fail to occur. Resolution of the uncertainty may confirm the acquisition of an asset or the reduction of a liability or the loss or impairment of an asset or the incurrence of a liability.

* * *

2. When a loss contingency exists, the likelihood that the future event or events will confirm the loss or impairment of an asset or the incurrence of a liability can range from probable to remote. This Statement uses the terms probable, reasonably possible, and remote to identify three areas within that range, as follows:

   a) Probable. The future event or events are likely to occur.

   b) Reasonably possible. The chance of the future event or events occurring is more than remote but less than likely.

   c) Remote. The chance of the future event or events occurring is slight.

3. Examples of loss contingencies include:

   a) Collectibility of receivables.

   b) Obligations related to product warranties and product defects.

   c) Risk of loss or damage of enterprise property by fire, explosion, or other hazards.

   d) Threat of expropriation of assets.

   e) Pending or threatened litigation.

   f) Actual or possible claims and assessments.

   g) Risk of loss from catastrophes assumed by property and casualty insurance companies including reinsurance companies.

   h) Guarantees of indebtedness of others.

i) Obligations of commercial banks under "standby letters of credit."

j) Agreements to repurchase receivables (or to repurchase the related property) that have been sold.

* * *

8. An estimated loss from a loss contingency (as defined in paragraph 1) shall be accrued by a charge to income if both of the following conditions are met:

a) Information available prior to issuance of the financial statements indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements. It is implicit in this condition that it must be probable that one or more future events will occur confirming the fact of the loss.

b) The amount of the loss can be reasonably estimated.

158. The SEC considers the disclosure of loss contingencies to be so important to an informed investment decision that it promulgated Regulation S-X, which provides that disclosures in interim period financial statements may be abbreviated and need not duplicate the disclosure contained in the most recent audited financial statements, <u>except that</u>, "where material contingencies exist, disclosure of such matters shall be provided even though a significant change since year end may not have occurred." 17 C.F.R. § 210.10-01.

159. In addition, GAAP provides that the objective of providing for an allowance for uncollectible accounts is to assure that, "[a]ccounts receivable net of

allowances for uncollectible accounts . . . are effectively stated as the amount of cash estimated as realizable." Accounting Research Bulletin ("ARB") No. 43, Restatement and Revision of Accounting Research Bulletins Chapter 3, Section 9 (June 1953).

160. There is an abundance of evidence showing that Friedman's violated FASB 5. As an initial matter, Friedman's allowance for uncollectible accounts that was set forth in the Company's September 27, 2001 press release was 10.5%. However, on November 11, 2003, Friedman's issued a press release, which stated that the increase in the allowance "is a result of the Company's experience that shows the related credit losses subsequently incurred have been higher than the estimates used to establish the allowance." Friedman's has not yet determined what portion, if any, of the increase will be recorded as a prior period adjustment. Additionally, the Company stated that it was not in position to provide guidance on the impact of the charge on fiscal 2003 earnings and that earnings will also be impacted by legal and other expenses related to the SEC, Capital Factors case and DOJ investigation.

161. Subsequently, the Company issued a press release on November 17, 2003 and a Form 8-K on that same day, signed by Defendant Stinn, announcing that the Audit Committee working with Defendant E&Y

> determined that the Company's historical financial statements for at least the fiscal years 2000, 2001 and 2001 and for the first three quarters of fiscal year 2003 will be restated. Accordingly, these financial statements and the related public filings with the SEC should no longer be relied upon. Ernst & Young has informed the Company that it is withdrawing its audit opinions on the previously-filed annual financial statements. The principal reason for the restatement is concern over the accounting for the allowance for doubtful accounts. . . . Based on the most recent information available, the Company now believes the allowance may exceed 17%.

162. Additionally, information obtained from former Friedman's employees bolsters the allegations in the Complaint. According to a former Finance Officer of the Southeast Region from 1998 through 2001, the allowance for uncollectible accounts was set by corporate accounting, specifically Defendants Stinn, Suglia and Mauro and Director of Credit Bill Milligan. Corporate headquarters set the allowance for uncollectible accounts so that each division was operating under the same methodology. The internal problems regarding bad debt is evidenced by the "Error Report" that was generated by the Company. The Finance Officer stated that the Error Report was generated "by corporate" or the Credit Manager in each Division and was available on the Company extranet. The Error Report showed which employee had erroneously approved the granting of credit and resulting therefrom, "everyone in the Company" knew that credit had not been approved in accordance with Company policy.

163. As accounts become uncollectible, GAAP required the uncollectible accounts to be charged-off. The amount of charge-offs was an integral part of Friedman's business, given their reliance upon their credit card receivables to generate income. In fact, during the Class Period, over 50% of all of the Company's sales involved use of the Company's own credit cards. According to the V.P. of Operations, a charge-off also affected bonus compensation as executives overseeing stores were paid 65% in salary and 35% in "deposit commission." In order to receive the "deposit commission," the amount of current accounts at the executive's store had to be at or above 83%. A customer's account would be considered "current" as of the date of the last payment rather than based on the amount past due. Charge-offs were closely monitored as a charge-off of an account would result in an increase in the currency level. The V.P. of Operations stated that charge-offs would float in and out of the Company's reports and that if a store were having a particularly good month, certain accounts would be placed back into the reports to be charged-off. Thus, Defendants manipulated the amounts charged-off based on the financial performance or lack thereof on a monthly basis.

164. The Regional Partner stated that Friedman's Corporate Officers were knowledgeable of the Company's accounts receivables and collection process. In

fact, on December 19, 2001 Defendant Anderson circulated an e-mail entitled "Collection Process Roll Out," attaching a new collection process guideline.

165. Defendant Anderson represented the following in the December 19, 2001 e-mail:

- the guideline was created by Corporate Headquarters and scheduled to be administered on January 2, 2002;
- Anderson personally reviewed the process guideline with "several operations people in the field and store partners and [had] received positive feedback on the process;"
- the goal of the new guideline "is to simplify the current process, address specific priorities by store, put into place an action plan to address critical stores and focus on making the collection call;"
- the Company was focusing on, *inter alia*, "keeping track of daily dollars collected;"
- Anderson would be participating in a conference call on the following Friday to discuss the guideline and would have "divisional conference calls" to insure proper implementation; and
- The process would be implemented Company-wide.

166. The Collection Process Guideline circulated by Defendant Anderson also contained the following information:

- Store information concerning accounts receivable were to be organized so they could be readily accessed;

- "Divisional offices will review all stores' collection performances on a weekly basis and in some instances, will qualify stores as 'Critical Stores.'"

- Corporate headquarters "will be generating a daily collection schedule by month," instructing employees "what grouping of accounts need to be called on a 'daily' basis."

- Corporate management considered collections a "major area of focus;"

- Corporate headquarters would "identify on your monthly RCD agings a 'priority' by age group to be worked. At the beginning of each month a breakdown of all RCD groups from RCD 1-5 will be provided;"

167. Corporate headquarters classified Friedman's credit customers within five detailed groups (RCD 0 – RCD 5) with comments on the characteristics of customers within each group; the likelihood of collection; the importance of attaining collection goals within each group; and the essential importance of making the "collection call."

168. A former Friedman's Corporate Controller who was employed with Friedman's from 1997 through 1998, and reported directly to Defendant Suglia during tenure with the Company, stated that Friedman's "had no rationale" for setting the reserves for uncollectible accounts and that they were "made based on how Brad Stinn said it would be." In fact, "as a matter of course," when an account didn't make a payment for 90 days, the credit department would "just re-

write the account to open it again, as if it was a new account." The Corporate Controller stated that Head of Credit Department Bill Milligan oversaw the operation, which was "standard procedure."

169. The Corporate Controller regularly expressed to Defendant Suglia a belief that the allowance for uncollectible accounts was too low and was informed that "Stinn makes the decisions." The Corporate Controller met with Defendant Suglia and Andrea Hughes, once a month in Defendant Suglia's office once the books closed for that month, to discuss the prior month's financial results and, at each meeting, they had a 5 to 25 minute discussion concerning the inadequate allowance.

170. Defendant Suglia was so involved in the Company's issuance of credit that, according to the Corporate Controller, Defendant Suglia worked directly in the Company's stores for "about 20 days" during the holiday season. The Corporate Controller recalled that, on more than one occasion, a customer would request credit when the Controller felt that there "was no way we can give credit." Defendant Suglia would respond that "we need to push sales" and would provide the credit regardless of the credit quality of the customer.

171. Additionally, the Corporate Controller stated that Company management "had continuous arguments with E & Y," over the allowance for

uncollectible accounts. The Corporate Controller recalls that E & Y "knew we were under-reserved." As a result, the E & Y Jacksonville, Florida office had discussions with Defendants Stinn and Suglia about the issue every quarter. Specifically, E & Y put together a "list of discussion items" every quarter and the reserves for doubtful accounts was "always on the list." Each quarter during the Class Period, E&Y reviewed the Company's financial statements for that quarter.

172. The Company also employed a scheme in which it artificially decreased the amount of bankrupt accounts on its financial statements. According to the V.P. of Operations, bankrupt accounts mysteriously disappeared from Friedman's income statement. These accounts made a reappearance as a charged-off account if the Company were having a successful month. Similar to charged-off accounts, bankrupt accounts had a direct effect upon Friedman's employees' compensation.

Overstatement of Inventory

173. According to Friedman's 2001 and 2002 Form 10-K's, the Company values inventory at the lower of weighted average cost or estimated market value. Despite the Company's pronouncement of its methodology for valuing inventory, Defendants' actual practice was to devise a scheme by which they would simultaneously overstate the value of Friedman's trade-in inventory and

improperly recognize revenue, as discussed in more detail above. By Defendants' failure to properly value and write-down Friedman's inventory, they contravened Accounting Research Bulletin 43 ("ARB 43"), which provides in pertinent part:

> The primary basis of accounting for inventories is cost, which has been defined generally as the price paid or consideration given to acquire an asset…. In keeping with the principle that accounting is primarily based on cost, there is a presumption that inventories should be stated at cost…. A departure from the cost basis of pricing the inventory is required when the utility of the goods is no longer as great as its cost. Where there is evidence that the utility of goods, in their disposal in the ordinary course of business, will be less than cost, whether due to physical deterioration, obsolescence, changes in price levels, or other causes, the difference should be recognized as a loss of the current period. This is generally accomplished by stating such goods at a lower level commonly designated as market.

174. According to the V.P. of Operations and a former Jewelry Buyer, employed by Friedman's for two years until departing from the Company in March 2004, Friedman's inventory was overstated by as much as \$30 to \$40 million as of March 2004. When a customer returns a product to Friedman's or trades in a product to Friedman's, that product is listed as "credit and trade" merchandise. Once a month, Friedman's sends this "credit and trade" merchandise to the Company's vault in Savannah. Friedman's lists "credit and trade" merchandise in the Company's vault as sellable inventory, notwithstanding the fact that this product remains in the vault and is not shown as product at Friedman's stores. The

Jewelry Buyer stated that a big problem facing Friedman's was that the salespeople would use credits and trades carte blanche in order to drive sales higher.

175. Additionally, as stated in more detail above, the V.P. of Operations detailed a scheme by which the Company would fictitiously overstate its inventory by allowing for trade-in credit to be offered to customers on the condition that the new purchase doubled the price of the trade. The V.P. of Operations described the trade-in inventory as "junk" that constituted half of the jewelry in the Company's vault. In fact, when looking at the Company's inventory in the vault, "[y]ou would just see mountains of junk, with a lot of it not even opened from the stores."

176. Friedman's executives "were absolutely aware of the credit and trade problems" according to the Finance Officer. In fact, in 1999 or 2000, Friedman's hired additional employees to kick the program of trading merchandise into gear. Additionally, there were many discussions in the finance department regarding what the Company was going to do with all of the merchandise that was unusable. Furthermore, when the Company moved its vault in either 1999 or 2000, it created a special section of the vault solely for credit and trade merchandise. This special section had to be created, according to the Finance Officer, because the Company was not able to sell nor return such merchandise. The credit and trade merchandise issue was frequently discussed during monthly "Operational Review" meetings, as

discussed in further detail below. Indeed, Friedman's has disclosed that the SEC and DOJ are investigating the value of Friedman's inventory.

Understatement of Accounts Payable

177. According to Friedman's 2002 Form 10-K, the Company includes the merchandise acquisition cost as an expense for the cost of goods sold. When the Company records an expense for the costs of good sold, the corresponding accounting entry should be to increase the Company's accounts payable. Friedman's failed to follow the mandates of GAAP and its own stated policy.

178. Friedman's actions contravene Accounting Concepts 5 ("CON 5") paragraph 85, which provides the method by which a Company should recognize an expense or loss. CON 5 paragraph 85 states that "[e]xpenses and losses are generally recognized when an entity's economic benefits are used up in delivering or producing goods, rendering services, or other activities that constitute its ongoing major or central operations or when previously recognized assets are expected to provide reduced or no further benefits."

179. Friedman's employed a scheme whereby it conspired with Crescent and Cosmopolitan to understate the Company's accounts payable and the related expenses. Cosmopolitan is a vendor that would sell jewelry to Friedman's on a consignment basis so that Cosmopolitan would receive compensation when

Friedman's sold the jewelry. Cosmopolitan also sold jewelry to Friedman's and Crescent at steep discounts well above customary industry practice. Capital Factors is a company that would lend money to Cosmopolitan based upon the accounts receivable of Cosmopolitan's customers, including Friedman's and Crescent, among others. Cosmopolitan's customers, including Friedman's and Crescent were delegated to submit payments for the jewelry directly to Capital Factors. The scheme employed was the following: Friedman's would send payments directly to Cosmopolitan rather than directly to Capital Factors as required by the contracts and would overstate the amount that Friedman's owed to Capital Factors. As a result, Friedman's would defer payment on the consigned goods and Capital Factors was induced to lend more money to Friedman's.

180. However, Friedman's later was forced to admit that the Company's restatement will include an adjustment to its accounts payable. Moreover, Friedman's affiliate Crescent admitted that it failed to properly state its accounts payable and the related expense on sales of consigned items.[2] Friedman's and Crescent had interrelated management, as discussed in more detail herein, and

[2] The Company's Prospectus Supplement on Form 424(b)(5) filed with the SEC on September 19, 2003 stated that Crescent's stockholder deficit was increased by $4 million to a total of $28 million that was recorded after Friedman's released pro forma consolidated financial information in April 2003, which showed a stockholders' deficit for Crescent of $24 million as of September 28, 2002.

Crescent's admission regarding the restatement of accounts payable indicates that Friedman's likewise engaged in the same accounting manipulation.

181. Cosmopolitan's customers, including Friedman's and Crescent, agreed to cooperate in the scheme for several reasons: (1) the customers were receiving excessive, unwarranted discounts and credits well above what was customarily granted in the industry; (2) the customers received substantial and extraordinary consignment shipments that allowed the customers to defer payment until actual sales of the goods – a significant advantage; and (3) Robert Morris, an officer of Cosmopolitan, who had previously worked at Friedman's and Crescent and is or was a member of the Crescent board of directors, had a longstanding relationship with Defendants Suglia and Mauro. Defendants Suglia and Mauro had authority to purchase goods from Cosmopolitan, negotiate discounts and direct payments.

182. Further evidence of Friedman's accounting manipulations is found in the Company's press release of September 12, 2003, when the Company announced that the SEC had initiated an informal inquiry into the lawsuit filed by Capital Factors regarding possible accounting improprieties with respect to Friedman's accounts payable. Additionally, on October 2, 2003, Friedman's

issued a press release announcing that the DOJ has notified it that it also was conducting an investigation into the Capital Factors lawsuit.

183. Subsequently, on October 23, 2003, Friedman's issued a press release and filed a Form 8-K, signed by Defendant Suglia, announcing "that it is rescheduling the release of its financial results for the fourth quarter and year ended September 27, 2003, originally scheduled for November 11, 2003." The Company further stated:

> The reason for the rescheduling is that the company's year-end closing process has been delayed due to the diversion of company resources necessary to fulfill information requests in connection with a previously announced investigation by the Department of Justice, a related informal inquiry by the Securities and Exchange Commission, and the Audit Committee investigation into the allegations asserted in the August 13, 2003, lawsuit filed by Capital Factors, Inc., a former factor of Cosmopolitan Gem Corporation, a former vendor of Friedman's, as well as other matters. These investigations and inquiries continue at the present time.
>
> As a result, the company will schedule the release of its forth quarter and year-end financial information at such time as the company and its auditors have completed the necessary work to certify the financial results. At this time, Friedman's does not anticipate a delay in the filing of its annual report on Form 10-K with the Securities and Exchange Commission for the 2003 fiscal year.

184. As the public now knows, the October 23, 2003 press release was just the tip of the iceberg.

IV.

E&Y'S PARTICIPATION IN THE FRAUD

185. Defendant E&Y served as auditor and principal accounting firm for Friedman's commencing prior to the time relevant to the facts alleged herein, and continuing at all relevant times hereto. The auditing standard of care is established by principles and standards recognized and accepted by the accounting profession. As certified public accounts and auditors, E&Y is charged with knowledge of, and must comply with, these principles and standards known as Generally Accepted Auditing Standards ("GAAS") and GAAP. E&Y is also charged with knowledge of, and must comply with all applicable law, including, but not limited to, SEC rules and regulations.

186. GAAS are promulgated by the American Institute of Certified Public Accountants ("AICPA") and embody ten standards, which concern an auditor's professional qualities and the judgment to be exercised in the performance of the auditor's examination and report. The GAAS standards include General Standards, Field Work Standards, and Reporting Standards as follows:

- General Standards
    - Training and Proficiency – requiring adequate training and proficiency as an auditor.
    - Independence – requiring independence in mental attitude by auditor.

  - Due Care – requiring due professional care to be exercised in planning and performing the audit and in preparing the audit report.

- Fieldwork Standards

  - Planning and Supervising – requiring audit work to be properly planned and any assistants to be supervised.
  - Internal Control – requiring sufficient understanding of the audited entity's internal control in order to plan the audit and determine tests to be performed.
  - Evidential Matter – requiring sufficient competent evidence to be obtained by auditor through inspection, observation, inquiry and confirmation to afford a reasonable basis for audit opinion.

- Reporting Standards

  - GAAP – requiring auditors' report to state whether financial statements are presented in accordance with generally accepted accounting principles.
  - Consistency – requiring auditor to identify deviations from accounting principles applied in previously audited period.
  - Disclosure – requiring informative disclosures in audited financial statements to be reasonably adequate.
  - Reporting Obligation – requiring an expression of the auditor's opinion of financial statements, or an assertion that an opinion cannot be expressed and the reason.

187. These ten auditing standards provide the professional framework for the Statement on Auditing Standards (SAS), promulgated by the Auditing

Standards Board (ASB) of the AICPA. Auditors are required by the SEC, and under the AICPA Code of Professional Conduct, to comply with these standards.

188. GAAP are promulgated by the Financial Accounting Standards Board and embody the conventions, rules and procedures necessary to define accepted accounting practices at a particular time. Additional GAAP based standards and principles governing accountancy include: Financial Accounting Standards ("FAS"); FAS Interpretations; and Accounting Principles Board ("APB") Opinions. E&Y is required to know and apply GAAP to meet its professional and contractual auditing obligations to Friedman's, including the First Reporting Standard of GAAS.

189. Financial audits, such as those E&Y was retained to conduct for Friedman's, require the verification of information contained in Friedman's financial statements through the examination of underlying accounting records and other audit evidence. E&Y, as auditors, was required, both professionally and contractually, to follow GAAS to determine whether Friedman's financial statements fairly presented Friedman's financial position and results of operation, including a determination of whether the financial statements are presented in accordance with GAAP.

190. E&Y breached 6 of the 10 required GAAS standards, to-wit: (a) 3rd General Standard – by failing to exercise due professional care in the planning and performance of Friedman's audit and in the preparation of E&Y's audit reports; (b) 1st Standard of Fieldwork – by negligently planning and supervising Friedman's audits; (c) 3rd Standard of Fieldwork – by failing to obtain through inspection, observation, inquiries and confirmations competent evidential matter to afford a reasonable basis for audit opinions on the financial statements; (d) 1st Standard of Reporting – by reporting that Friedman's financial statements were presented in accordance with GAAP; (e) 3rd Standard of Reporting – by failing to determine whether informative disclosures in financial statements were reasonably adequate; and (f) 4th Standard of Reporting – by issuing unqualified audit reports on materially misstated financial statements.

191. E&Y's breach of GAAS is evidenced, in part, by its withdrawal of its unqualified audit opinions for the 2000-2002 audits.[3] E&Y's knowledge or severe

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[3] AU Section 561, "Subsequent Discovery of Facts Existing at the Date of the Auditor's Report" sets forth the implications of E&Y's withdrawal of its unqualified audit opinion:

.05 When the subsequently discovered information is found both to be reliable and to have existed at the date of the auditor's report, the auditor should take action in accordance with the procedures set out in subsequent paragraphs if the nature and effect of the matter are such that (*a*) his report would have been affected if the information had been known to him at the date of his report and had not been reflected in the financial statements and (*b*) he believes there are persons currently relying or likely to rely on the financial statements who would attach importance to the information. With respect to (*b*), consideration should be given, among other things, to the time elapsed since the financial statements were issued.

.06 When the auditor has concluded, after considering (*a*) and (*b*) in that action should be taken to prevent future reliance on his report, he should advise his client to make appropriate disclosure of the newly discovered facts and their impact on the financial statements to persons who are known to be currently relying or who are likely to rely on the financial statements and the related auditor's report. When the client undertakes to make appropriate disclosure, the method used and the disclosure made will depend on the circumstances.

a. If the effect on the financial statements or auditor's report of the subsequently discovered information can promptly be determined, disclosure should consist of issuing, as soon as practicable, revised financial statements and auditor's report. The reasons for the revision usually should be described in a note to the financial statements and referred to in the auditor's report. Generally, only the most recently issued audited financial statements would need to be revised, even though the revision resulted from events that had occurred in prior years.

b. When issuance of financial statements accompanied by the auditor's report for a subsequent period is imminent, so that disclosure is not delayed, appropriate disclosure of the revision can be made in such statements instead of reissuing the earlier statements pursuant to subparagraph (*a*).

c. When the effect on the financial statements of the subsequently discovered information cannot be determined without a prolonged investigation, the issuance of revised financial statements and auditor's report would necessarily be delayed. In this circumstance, when it appears that the information will require a revision of the statements, appropriate disclosure would consist of notification by the client to persons who are known to be relying or who are likely to rely on the financial statements and the related report that they should not be relied upon, and that revised financial statements and auditor's report will be issued upon completion of an investigation. If applicable, the client should be advised to recklessness that it was violating GAAS is detailed below. In addition, E&Y also participated in the fraud by violating GAAS for the aforementioned reasons in connection with E&Y's audits of Crescent, whose financial statements formed the basis for Friedman's investment in Crescent. The value of Friedman's investment in Crescent appears as an asset on the Company's financial statements issued during the Class Period.

192. Friedman's 2000 Form 10-K included E&Y's unqualified audit report dated November 20, 2000, which falsely represented that E&Y had conducted its audit for Friedman's year-end 2000 financial statements in accordance with GAAS, and that Friedman's financial statements conformed with GAAP:

> We conducted our audits in accordance with auditing standards generally accepted in the 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. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

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discuss with the Securities and Exchange Commission, stock exchanges, and appropriate regulatory agencies the disclosure to be made or other measures to be taken in the circumstances

> In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Friedman's Inc. at September 30, 2000 and 1999, and the consolidated results of its operations and its cash flows for each of the three years in the period ended September 30, 2000, in conformity with accounting principles generally accepted in the United States. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

193. Contrary to the statements in its audit report, E&Y did not perform its 2000 audit in accordance with GAAS, and the financial statements were not in conformity with GAAP. These violations greatly enhanced and facilitated the fraudulent and unlawful scheme to understate the allowance for uncollectible accounts, overstate inventory, understate its accounts payable and cost of goods sold, ignore addressing a possible impairment of Friedman's investment in Crescent, and overstate revenue, net income and EPS as alleged herein. Moreover, these statements in the audit report were materially false and misleading when made as indicated by the withdrawal of E&Y's audit opinion.

194. Friedman's 2001 Form 10-K included E&Y's unqualified audit report dated October 26, 2001, which falsely represented that E&Y had conducted its audit for Friedman's year-end 2001 financial statements in accordance with GAAS, and that Friedman's financial statements conformed with GAAP:

> We conducted our audits in accordance with auditing standards generally accepted in the 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. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.
>
> In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Friedman's Inc. at September 29, 2001 and September 30, 2000, and the consolidated results of its operations and its cash flows for each of the three years in the period ended September 29, 2001, in conformity with accounting principles generally accepted in the United States. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

195. Contrary to the statements in its audit report, E&Y did not perform its 2001 audit in accordance with GAAS, and the financial statements were not in conformity with GAAP. These violations greatly enhanced and facilitated the fraudulent and unlawful scheme to understate the allowance for uncollectible accounts, overstate inventory, understate its accounts payable and cost of goods sold, ignore addressing a possible impairment of Friedman's investment in Crescent, and overstate revenue, net income and EPS as alleged herein. Moreover,

these statements in the audit report were materially false and misleading when made as indicated by the withdrawal of E&Y's audit opinion.

196. Also, on December 28, 2001, Friedman's filed an S-3 Registration Statement in Connection with the Company's public offering of February 6, 2002. The Registration Statement included E&Y's consent dated December 21, 2001, which stated that:

> We consent to the reference to our firm under the caption "Experts" in the Registration Statement (Form S-3 No.333-XXXXXXXX) and the related Prospectus of Friedman's Inc. for the registration of its common stock, preferred stock, warrants, debts securities and guarantees of debt securities and to the incorporation by reference therein of our report dated October 26, 2001, with respect to the consolidated financial statements and schedule of Friedman's Inc. included in its Annual Report (Form 10-K) for the year ended September 29, 2001, filed with the Securities and Exchange Commission.

197. As stated above, contrary to the statements in its audit report, E&Y did not perform its 2001 audit in accordance with GAAS, and the financial statements were not in conformity with GAAP. These violations greatly enhanced and facilitated the fraudulent and unlawful scheme to understate the allowance for uncollectible accounts, overstate inventory, understate its accounts payable and cost of goods sold, ignore addressing a possible impairment of Friedman's investment in Crescent, and overstate revenue, net income and EPS as alleged

herein. Moreover, the consent was materially false and misleading when made as indicated by the withdrawal of E&Y's audit report.

198. On January 24, 2002 and February 6, 2002, Friedman's filed Prospectus Supplements on Form 424(b)(5) in connection with the Company's public offering on February 6, 2002. In the Prospectus Supplements, Friedman's incorporated its 2001 Form 10-K, including the unqualified audit opinion of E&Y, which is quoted above. For the same reasons as stated above, E&Y did not perform its 2001 audit in accordance with GAAS, and the financial statements were materially false and misleading and not in conformity with GAAP.

199. Friedman's 2002 Form 10-K included E&Y's unqualified audit report dated November 1, 2002, which falsely represented that E&Y had conducted its audit for Friedman's year-end 2002 financial statements in accordance with GAAS, and that Friedman's financial statements conformed with GAAP:

> We conducted our audits in accordance with auditing standards generally accepted in the 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. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

> In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Friedman's Inc. at September 28, 2002 and September 29, 2001, and the consolidated results of its operations and its cash flows for each of the three years in the period ended September 28, 2002, in conformity with accounting principles generally accepted in the United States. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

200. Contrary to the statements in its audit report, E&Y did not perform its 2002 audit in accordance with GAAS, and the financial statements were not in conformity with GAAP. These violations greatly enhanced and facilitated the fraudulent and unlawful scheme to understate the allowance for uncollectible accounts, overstate inventory, understate its accounts payable and cost of goods sold, ignore addressing a possible impairment of Friedman's investment in Crescent, and overstate revenue, net income and EPS as alleged herein. Moreover, these statements in the audit report were materially false and misleading when made as indicated by the withdrawal of E&Y's audit report.

201. On May 20, 2003, Friedman's filed an S-8 Registration Statement in connection with the Company's employee stock plans. The Registration Statement included E&Y's consent dated May 15, 2003, which stated that:

> We consent to the incorporation by reference in this registration statement on Form S-8 pertaining to the Friedman's Inc. 1999 Long-

> Term Incentive Plan, as amended and the Friedman's Inc. 1994 Qualified Employee Stock Purchase Plan, as amended of our report dated November 1, 2002, with respect to the consolidated financial statements and schedule of Friedman's Inc. included in its Annual Report (Form 10-K) for the year ended September 30, 2002, filed with the Securities and Exchange Commission.

202. As stated above, contrary to the statements in its audit report, E&Y did not perform its 2002 audit in accordance with GAAS, and the financial statements were not in conformity with GAAP. These violations greatly enhanced and facilitated the fraudulent and unlawful scheme to understate the allowance for uncollectible accounts, overstate inventory, understate its accounts payable and cost of goods sold, ignore addressing a possible impairment of Friedman's investment in Crescent, and overstate revenue, net income and EPS as alleged herein. Moreover, the statements in the audit and E&Y's consent were materially false and misleading when made as indicated by the withdrawal of E&Y's audit report.

203. On September 19, 2003, Friedman's filed a Prospectus Supplement on Form 424(b)(5) in connection with the Company's public offering on September 19, 2003. In the Prospectus Supplement, Friedman's incorporated its 2002 Form 10-K, including the unqualified audit opinion of E&Y, which is quoted above. For the same reasons as stated above, E&Y did not perform its 2002 audit in

accordance with GAAS, and the financial statements were not in conformity with GAAP. Moreover, these statements in the audit report were materially false and misleading when made as indicated in by the withdrawal of E&Y's audit report.

204. Subsequently, on November 17, 2003, Friedman's announced in a press release that the Audit Committee working with Defendant E&Y "has determined that the Company's historical financial statements for at least the fiscal years 2000, 2001 and 2001 and for the first three quarters of fiscal year 2003 will be restated. Accordingly, these financial statements and the related public filings with the SEC should no longer be relied upon. Ernst & Young has informed the Company that it is withdrawing its audit opinions on the previously-filed annual financial statements."

205. E&Y represented in unqualified audit opinions in connection with the filing of Friedman's 10-K's and consent letters in connection with two secondary offerings that its audits for the fiscal years ended 2000, 2001 and 2002 were performed in a manner consistent with GAAS. Such representations were materially false, misleading and without reasonable basis.

206. E&Y violated GAAS by, among other things, failing to expand or otherwise properly conduct its audit to detect the understatement in the allowance for uncollectible accounts, overstatement of inventory, understatement of accounts

payable and cost of goods sold, a possible impairment write-down of Friedman's investment in Crescent, and overstatement of revenue, net income and EPS, as alleged in ¶¶ 143-184 above.

207. E&Y's failure to qualify, modify or abstain from issuing its audit opinion, when it knew or severely recklessly turned a blind eye to Friedman's accounting manipulations, caused E&Y to violate at least the provisions of GAAS, discussed in detail below.

208. According to AICPA, Codification of Statements on Auditing Standards (AU) § 150.02, GAAS' first standard of field work requires that audit work be adequately planned. Particularly, GAAS provides that "in planning the audit, the auditor should consider, among other matters . . . conditions that may require extension or modification of audit tests, such as the risk of material error or fraud or the existence of related party transactions." AU § 311.03. See also AU § 316A ("Consideration of Fraud in a Financial Statement Audit"). Contrary to this standard, E&Y failed to adequately plan the 2000-2002 audits after learning of several facts over a short period of time that, either standing alone or in the context of the other facts learned during that period, constituted red flags that should have alerted it to the possibility that Friedman's financial statements were misstated due to fraud.

209. Audit Standard 316, paragraph 16 ("AU 316") states that risk factors relating to misstatements arising from fraudulent financial reporting may be grouped into categories, including, *inter alia*: (a) *Management's characteristics and influence over the control environment*. These pertain to management's abilities, pressures, style, and attitude relating to internal control and the financial reporting process; and (c) *Operating characteristics and financial stability*. These pertain to the nature and complexity of the entity and its transactions, the entity's financial condition, and its profitability.

210. Examples of risk facts relating to misstatements arising from fraudulent financial reporting are set forth in AU 316, paragraph 17:

> (a) *Risk factors relating to management's characteristics and influence over the control environment*. Examples include –
>
> - A motivation for management to engage in fraudulent financial reporting. Specific indicators might include –
>
>   -- A significant portion of management's compensation represented by bonuses, stock options or other incentives, the value of which is contingent upon the entity achieving unduly aggressive targets for operating results, financial position, or cash flow.
>
>   -- An excessive interest by management in maintaining or increasing the entity's stock price or earnings trend through the use of unusually aggressive accounting practices.

-- A practice by management of committing to analysts, creditors, and other third parties to achieve what appear to be unduly aggressive or clearly unrealistic forecasts.

* * *

- A failure by management to display and communicate an appropriate attitude regarding internal control and the financial reporting process. Specific indicators might include –

* * *

-- Domination of management by a single person or small group without compensating controls such as effective oversight by the board of directors or audit committee.

-- Inadequate monitoring of significant controls.

-- Management failing to correct known reportable conditions on a timely basis.

-- Management setting unduly aggressive financial targets and expectations for operating personnel.

* * *

(c) *Risk factors relating to operating characteristics and financial stability*. Examples include --

* * *

- Significant pressure to obtain additional capital necessary to stay competitive considering the financial position of the entity – including need for funds to finance major research and development or capital expenditures.

- Assets, liabilities, revenues, or expenses based on significant estimates that involve unusually subjective judgments or uncertainties, or that are subject to potential significant change in the near term in a manner that may have a financially disruptive effect on the entity – such as ultimate collectibility of receivables, timing of revenue recognition, realizability of financial instruments based on the highly subjective valuation of collateral or difficult-to-assess repayment sources, or significant deferral of costs.

- Significant related-party transactions not in the ordinary course of business or with related entities not audited or audited by another firm.

- Significant, unusual, or highly complex transactions, especially those close to year end, that pose difficult "substance over form" questions.

* * *

- Unusually high dependence on debt or marginal ability to meet debt repayment requirements; debt covenants that are difficult to maintain.

- Unrealistically aggressive sales or profitability incentive programs.

* * *

211. E&Y knew or was severely reckless in not knowing that the fraudulent activities by Friedman's and Crescent resulted in each company's financial statements contravening the provisions of GAAP. This is evidenced by: (1) the interrelationship between E&Y, Friedman's and Crescent; (2) the massive fraud committed by Crescent resulting in E&Y's resignation from the Crescent engagement; (3) Friedman's statement in the March 15, 2004 press release that

Crescent's financial information should not be relied upon and would be restated; (4) Friedman's and Crescent's involvement in the fraudulent scheme to defraud Capital Factors; and (5) E&Y's withdrawal of its unqualified audit opinions for the 2000-2002 audits of Friedman's.

212. Furthermore, according to the Corporate Controller, there were continuous arguments between Friedman's and E&Y over the allowance for uncollectible accounts. These E&Y auditors were in E&Y's Jacksonville, Florida office. The Corporate Controller stated that E&Y's audit supervisor and manager possessed knowledge that Friedman's understated the allowance for uncollectible accounts. As a result, E&Y's audit partner would prepare a "list of discussion items" and the allowance for uncollectible accounts was always on the list. The E&Y audit partner also had discussions with Defendants Stinn and Suglia about this topic on a quarterly basis.

213. Additional evidence of E&Y's knowledge or severe recklessness is found in the fact that E&Y received significant fees for its consulting beyond the fees for its auditing services. This may cause E&Y's independence to be called into question. Also, Defendant Pickup, the Chairman of Friedman's audit committee, was a former partner of E&Y.

214. Additionally, AU 316 paragraph 23 states that Section 319 entitled "*Consideration of Internal Control in a Financial Statement Audit*," requires the auditor to obtain a sufficient understanding of the entity's internal control over financial reporting to plan the audit. It also notes that such knowledge should be used to identify types of potential misstatements, consider factors that affect the risk of material misstatement and design substantive tests. The understanding will affect the auditor's consideration of the significance of fraud risk factors. In addition, when considering the significance of fraud risk factors, the auditor may wish to assess whether there are specific controls that mitigate the risk or whether specific control deficiencies may exacerbate the risk.

215. Under AU 316 paragraph 27, Judgments about the risk of material misstatement due to fraud may affect the audit in the following ways:

- *Professional skepticism*. Due professional care requires the auditor to exercise professional skepticism – that is, an attitude that includes a questioning mind and critical assessment of audit evidence. Some examples demonstrating the application of professional skepticism in response to the auditor's assessment of the risk of material misstatement due to fraud include (a) increased sensitivity in the selection of the nature and extent of documentation to be examined in support of material transactions; and (b) increased recognition of the need to corroborate management explanations or representations concerning material matters – such as further analytical procedures, examination of documentation or discussion with others within or outside the entity.

* * *

- *Accounting principles and policies*. The auditor may decide to consider further management's selection and application of significant accounting policies, particularly those related to revenue recognition, asset valuation, or capitalizing versus expensing. In this respect, the auditor may have a greater concern about whether the accounting principles selected and policies adopted are being applied in an inappropriate manner to create a material misstatement of the financial statements.

216. Some examples of responses to the auditor's assessment of the risk of material misstatements arising from fraudulent financial reporting are set forth in AU 316, paragraph 30:

- ***Revenue recognition***. If there is a risk of material misstatement due to fraud that may involve or result in improper revenue recognition, it may be appropriate to confirm with customers certain relevant contract terms and the absence of side agreements – inasmuch as the appropriate accounting is often influenced by such terms or agreements. For example, acceptance criteria, delivery and payment terms and the absence of future or continuing vendor obligations, the right to return the product, guaranteed resale amounts, and cancellation or refund provisions often are relevant in such circumstances.

- ***Inventory quantities***. If a risk of material misstatement due to fraud exists in inventory quantities, reviewing the entity's inventory records may help to identify locations, areas or items for specific attention during or after the physical inventory count. Such a review may lead to a decision to observe inventory counts at certain locations on an unannounced basis. In addition, where the auditor has a concern about the risk of material misstatement due to fraud

> in the inventory area, it may be particularly important that he entity counts are conducted at all locations subject to count on the same date. Furthermore, it also may be appropriate for the auditor to apply additional procedures during the observation of the count – for example, examining more rigorously the contents of boxed items, the manner in which the goods are stacked or labeled, and the quality of liquid substances. Finally, additional testing of count sheets, tags or other records, or the retention of copies may be warranted to minimize the risk of subsequent alteration or inappropriate compilation.

217. E&Y possessed knowledge or was severely reckless in not possessing knowledge of Friedman's improper recognition of revenue, see ¶¶ 151-155 above, and Friedman's overstatement of inventory, see ¶¶ 173-176 above.

218. Despite being aware of the foregoing red flags, E&Y failed to design audit procedures to test Friedman's allowance for uncollectible accounts, inventory, accounts payable, the value of the Crescent investment, net income and EPS more extensively than originally planned, or heighten its scrutiny in its audit to obtain greater assurances that Friedman's allowance for uncollectible accounts, inventory, accounts payable, the value of the Crescent investment, net income and EPS were accurately stated.

219. SAS No. 57 (AU Section 342), *Auditing Accounting Estimates*, "provides guidance to auditors on obtaining and evaluating sufficient competent evidential matter to support significant accounting estimates in an audit of financial

statements in accordance with generally accepted auditing standards." "Accounting estimates" as the term is defined by the standard includes reserves for "uncollectible receivables."

220. SAS No. 57 recognizes that while management is responsible for making the accounting estimate,

> **The auditor is responsible for evaluating the reasonableness of accounting estimates made by management** in the context of the financial statements taken as a whole. As estimates are based on subjective as well as objective factors, it may be difficult for management to establish controls over them. **Even when management's estimation process involves competent personnel using relevant and reliable data, there is potential for bias in the subjective factors**. Accordingly, when planning and performing procedures to evaluate accounting estimates, the auditor should consider, with an attitude of professional skepticism, both the subjective and objective factors.

221. Indeed, SAS No. 57 requires the auditor to assess whether management's "accounting estimates are reasonable," "are presented in conformity with applicable accounting principles," and "are properly disclosed."

222. SAS No. 57 provides further that,

> In evaluating reasonableness, **the auditor should obtain an understanding of how management developed the estimate**. Based on that understanding, the auditor should use one or a combination of the following approaches:
>
> *a.* **Review and test the process used by management to develop the estimate.**

> *b.* **Develop an independent expectation of the estimate to corroborate the reasonableness of management's estimate.**
>
> *c.* Review subsequent events or transactions occurring prior to completion of fieldwork.

223. SAS No. 61 (AU Sec. 380), *Communication with Audit Committees*," states that "the auditor should determine that the audit committee is informed about the process used by management in formulating particularly sensitive accounting estimates and about the basis for the auditor's conclusions regarding the reasonableness of those estimates." Additionally, SAS No. 61 "requires auditors of Securities and Exchange Commission (SEC) clients to discuss with audit committees the auditor's judgments about the quality, and not just the acceptability, of the company's accounting principles and underlying estimates in its financial statements."

224. APB 20 provides that, where a company misjudges an estimate for accounting purposes, the misjudgment should be corrected prospectively through a charge to revenues. Conversely, a restatement, like that forthcoming from Friedman's for 2000-2003, is required where the company committed an "error." An "error" in financial statements results from "mathematical mistakes, mistakes in the application of accounting principles, or oversight or misuse of facts that

existed at the time the financial statements were prepared." FAS 16 calls such restatements "rare in modern financial accounting."

225. The pervasiveness of the fraud involving Friedman's understated reserves (more than three years); the requirement that E&Y independently review and test the Company's reserve calculations; the fact that the Company purportedly wrote off uncollectible accounts after 120 days; the requirement that E&Y assess whether the Company's actual write-offs warrant an increase in the Company's reserve for doubtful accounts; and the rarity of such a vast restatement and corresponding withdrawal of E&Y's audit opinions all provide evidence that E&Y knew and/or severely recklessly disregarded that its Class Period statements and omissions were materially false and misleading.

226. During the course of E&Y's audits of Friedman, there appeared numerous "red flags" that should have raised questions in the auditors' minds and led them to procure additional evidential matter. In conducting an audit, an auditor must obtain sufficient competent evidential matter through inspection, observation, inquiries and confirmations to afford a reasonable basis for an opinion regarding the financial statements under audit. AU § 326.01.

227. E&Y did not obtain sufficient competent evidential matter upon which to base its audit opinions and thus did not exercise due professional care, despite the numerous red flags.

228. For example, GAAS required E&Y, at a minimum, to develop sufficient competent evidential matter for its opinion regarding whether inventory, among other things, is properly stated at the lower of cost or market is lower; slow-moving, excess, defective, and obsolete items included in inventories are properly identified; and inventories are reduced, when appropriate, to replacement cost or net realizable value. AU § 326.26. Instead, E&Y relied on management's representations. E&Y knew or was severely reckless in not knowing that Friedman's inventory ranked as one of the most material to the Company's financial results during the Class Period. Indeed, during the fiscal years 2000, 2001, and 2002, inventory represented 38%, 30%, and 30% of total assets, respectively. Accordingly, E&Y knew of or severely recklessly disregarded the consequences of Friedman improperly valuing its inventory.

229. Moreover, E&Y ignored the audit guidance that states "[m]ost of the independent auditor's work in forming his or her opinion on financial statements consists of obtaining and evaluating evidential matter concerning the assertions in such financial statements. AU § 326.02. Accordingly, E&Y in obtaining and

evaluating competent evidential matter regarding management's assertion regarding the value of Friedman's inventory, needed to:

- Tour facilities holding inventory. AU 326.26.
- Inquire of sales personnel concerning possible excess or obsolete inventory items. Id.
- Analyze the relationships of inventory balances to anticipated sales volume. Id.

230. To be sure, E&Y could not have fulfilled the foregoing responsibilities, because: (1) had E&Y toured the facility, it would have discovered that the inventory from "credits and trades" had accumulated to such an exorbitant level that the Company had to setup a special section in the vault; (2) had E&Y inquired of sales personnel regarding excess and obsolete inventory, it would have discovered $100 million in "problem inventory"; (3) had E&Y analytically compared the relationship of inventory balances to anticipated sales, it would have discovered that the Company had more than a twenty-four month supply.

231. E&Y also failed to obtain and evaluate sufficient competent evidential matter to support significant accounting estimates related to Friedman's uncollectible receivables. See AU § 342. In this regard, E&Y was responsible for evaluating whether Friedman's estimate of uncollectible receivables was reasonable. See AU § 342.04. Friedman's estimates related to uncollectible

receivables were not reasonable due to Friedman's manipulations and overrides of internal controls and processes related to Friedman's granting of credit. Indeed, because of Friedman's manipulations of its credit policies and the fact that charge-offs drifted in and out of monthly Company store reports, neither its historical nor current data on which Friedman based its allowance for uncollectible accounts, were reliable. Accordingly, E&Y could not have identified whether Friedman was developing sufficiently reliable accounting estimates. Indeed, Friedman's estimates of uncollectible accounts receivables were not reasonable based on the problems, as discussed in detail below in ¶¶244-300, and as evidenced by the Company's announced restatement of "historical financial statements for at least the fiscal years 2000, 2001 and 2002 and for the first three quarters of fiscal year 2003 . . . [because of the] concern over the accounting for the allowance for doubtful accounts."

232. As one of the largest audit firms in the world, E&Y was well aware of the strategies, methods and procedures required by GAAS to conduct a proper audit. Also, E&Y knew of the audit risks inherent at Friedman's and the industry in which Friedman's operated because of the comprehensive services it provided to Friedman's, as well as Crescent, over the years and its experience in the retail and consumer industry. E&Y's intentional or severely reckless failure to comply with

GAAS and E&Y's performance on the Friedman's audits rose to the level of severe recklessness and/or knowing fraud.

233. Indeed, E&Y touted its expertise in retail and consumer product related companies, such as, Friedman's. For example, according to E&Y's website (ey.com):

> Being a success in Retail & Consumer Products (RCP) takes more than knowing where you are today and where you want to go.
>
> The unique qualities of doing business in the sector mean: You've got to understand your benchmarks of operational, financial, and competitive excellence. You have to know the impact of regulation, globalization, and consolidation. You have to be able to deal with product life cycles, capital markets, and technology.
>
> The right people, the right skills. Our firm continually strives to deliver the kind of value that can help improve your revenue growth, operational efficiency, and capital management. How do we do this? By having the right people—with the experience, as well as the understanding of innovation, knowledge management, and technology—wherever in the world they are needed.
>
> Working with clients. We leverage our local, national and international RCP professionals to serve clients everywhere. This global network works with clients to tailor solutions to specific business needs, lending insight and best practices, and bringing valuable industry-focused ideas.
>
> From sophisticated supply chain management to cutting-edge E-Commerce and comprehensive new product development, we can offer you the strategic, operational, and technical services critical to today's businesses. The goal is to achieve meaningful, measurable results.

234. E&Y violated GAAS and the standards set forth in SAS No. 1 and SAS No. 53 by, *inter alia*, failing to adequately plan its audit and properly supervise the work of assistants and to establish and carry out procedures reasonably designed to search for and detect the existence of errors and irregularities that would have a material effect upon the financial statements.

235. E&Y violated GAAS Standard of Field Work No. 2, which requires the auditor to make a proper study of existing internal controls, including accounting, financial and managerial controls, to determine whether reliance thereon was justified, and, if such controls are not reliable, to expand the nature and scope of the auditing procedures to be applied. The standard provides that a sufficient understanding of an entity's internal control structure be obtained to adequately plan the audit and to determine the nature, timing and extent of tests to be performed. AU § 150.02. In all audits, the auditor should perform procedures to obtain a sufficient understanding of three elements of an entity's internal control structure: the control environment; the accounting system; and control procedures. AU § 319.02.

236. As a result of its failure to accurately report on Friedman's fiscal 2000, 2001, and 2002 financial statements, E&Y utterly failed in its role as an auditor as defined by the SEC. SEC Accounting Series Release No. 296,

Relationships Between Registrants and Independent Accountants, Securities Act Release No. 6341, Exchange Act Release No. 18044, states in part:

> Moreover, the capital formation process depends in large part on the confidence of investors in financial reporting. An investor's willingness to commit his capital to an impersonal market is dependent on the availability of accurate, material and timely information regarding the corporations in which he has invested or proposes to invest. The quality of information disseminated in the securities markets and the continuing conviction of individual investors that such information is reliable are thus key to the formation and effective allocation of capital. Accordingly, the audit function must be meaningfully performed and the accountants' independence not compromised. The auditor must be free to decide questions against his client's interests if his independent professional judgment compels that result.

237. E&Y's opinions, which represented that Friedman's fiscal 2000, 2001, and 2002 year end financial statements were presented in conformity with GAAP, were materially false and misleading because E&Y knew or was severely reckless in not knowing that Friedman's fiscal 2000, 2001, and 2002 year end financial statements violated the principles of fair reporting and GAAP. In the course of rendering its unqualified audit certification on Friedman's fiscal 2000-2002 year end financial statements, E&Y knew it was required to adhere to each of the herein described standards and principles of GAAS, including the requirement that the financial statements comply in all material respects with GAAP. E&Y, in issuing its unqualified opinions, knew or severely recklessly disregarded that by

doing so it was engaging in gross departures from GAAS, thus making its opinions false, and issued such certifications knowing or severely recklessly disregarding that GAAS had been violated.

238. E&Y knew or severely recklessly disregarded facts indicating that it should have: (a) disclaimed or issued adverse opinions on Friedman's fiscal 2000-2002 year end financial statements; or (b) withdrawn, corrected or modified its opinions for fiscal years 2000, 2001 and 2002 to recognize Friedman's improper accounting and financial reporting as stated above.

239. E&Y also failed to obtain sufficient competent evidential matter. GAAS' third standard of field work requires that "[s]ufficient competent evidential matter is to be obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the financial statements under audit." AU § 150.02. E&Y failed to obtain sufficient competent evidential matter in several areas of the 2000-2002 audits.

240. E&Y knew or was severely reckless in not knowing that the 10.5% reserve for uncollectible accounts was understated and that it should have been set at 17% or greater based on historical experience of charge-offs. Additionally, E&Y knew or was severely reckless in not knowing that the inventory was overstated by at least $30 to $40 million. Furthermore, E&Y knew or was severely

reckless in not knowing that Friedman's, as well as Crescent, understated its accounts payable and cost of goods sold based on the scheme whereby Friedman's sent payments directly to Cosmopolitan rather than directly to Capital Factors and overstated the amount that Friedman's and Crescent represented to Capital Factors was owed to Cosmopolitan. E&Y's review of the terms and conditions of the transactions between Friedman's, Crescent and Cosmopolitan would have shown the extraordinary discounts received by Friedman's and Crescent, indicating Friedman's accounts payable was understated. As E&Y was the auditor for both Friedman's and Crescent, it knew or should have known that the value of Friedman's investment in Crescent was impaired and that Friedman's should have taken a write-down of the investment. See also ¶¶ 143-150 above.

241. Under AU § 150.02, GAAS' first standard of reporting states that "[t]he report shall state whether the financial statements are presented in accordance with generally accepted accounting principles." Contrary to this standard, E&Y issued an unqualified audit report on Friedman's 2000-2002 financial statements even though it knew or was severely reckless in not knowing that the financial statements did not conform to GAAP. Under AU § 150.02, GAAS' third standard of reporting states that "[i]nformative disclosures in the financial statements are to be regarded as reasonably adequate unless otherwise

stated in the report." Contrary to this standard, E&Y issued an unqualified audit report on Friedman's 2000-2002 financial statements even though it knew or was severely reckless in not knowing that the financial statements did not conform to GAAP. Under AU § 150.02, GAAS' fourth standard of reporting states that "[t]he report shall contain either an expression of opinion regarding the financial statements, taken as a whole, or an assertion to the effect that an opinion cannot be expressed. When an overall opinion cannot be expressed, the reasons therefore should be stated. In all cases where an auditor's name is associated with financial statements, the report should contain a clear-cut indication of the character of the auditor's work, if any, and the degree of responsibility the auditor is taking." Contrary to this standard, E&Y issued an unqualified audit report on Friedman's 2000-2002 financial statements even though it knew or was severely reckless in not knowing that the financial statements did not conform to GAAP.

E&Y Violated Section 10A(b)(1) of the Exchange Act

242. During the time of the conduct described above, Section 10A(b)(1) of the Exchange Act provides in relevant part:

> If, in the course of conducting an audit . . ., the independent public accountant detects or otherwise becomes aware of information indicating that an illegal act (whether or not perceived to have a material effect on the financial statements of the issuer) has or may have occurred, the accountant shall, in accordance with generally

> accepted accounting standards . . . determine whether it is likely that an illegal act has occurred; and if so, determine and consider the possible effect of the illegal act on the financial statements of the issuer . . . and as soon as practicable, inform the appropriate level of the management of the issuer and assure that the audit committee of the issuer, or the board of directors . . . in the absence of such a committee, is adequately informed with respect to illegal acts that have been detected or have otherwise come to the attention of such accountant in the course of the audit, unless the illegal act is clearly inconsequential.

243. E&Y knew or was severely reckless in not knowing that Friedman's improperly understated its allowance for uncollectible accounts, overstated the value of the Company's inventory, understated the amount of Friedman's accounts payable and cost of goods sold, ignored addressing a possible impairment of Friedman's investment in Crescent and overstated revenue, net income and EPS, as described in ¶¶ 143-184 above.

V. SCIENTER

244. As alleged herein, Friedman's, the Individual Defendants and E&Y acted with scienter in that these Defendants knew or were severely reckless in not knowing that the public documents and statements the Company and E&Y issued or disseminated were materially false and misleading; knew or severely recklessly disregarded that such statements or documents would be issued or disseminated to the investing public; and knowingly or severely recklessly substantially

participated or acquiesced in the issuance or dissemination of such statements or documents as primary violators of the federal securities laws.

245. As set forth herein in detail, Defendants, by virtue of their receipt of information reflecting the true facts regarding Friedman’s and its business practices, their control over and/or receipt of Friedman's allegedly materially misleading misstatements and/or their associations with the Company that made them privy to confidential proprietary information concerning Friedman’s, were active and culpable participants in the fraudulent scheme alleged herein. These Defendants knew and/or severely recklessly disregarded the falsity and misleading nature of the information, which they caused to be disseminated to the investing public. The ongoing fraudulent scheme described in this complaint could not have been perpetrated over a substantial period of time, as has occurred, without the knowledge and/or severe recklessness and complicity of the personnel at the highest level of the Company, including the Individual Defendants and Friedman’s independent auditor, E&Y.

246. The magnitude of Friedman’s restatement, which has not yet occurred as a result of the massive and egregious nature and amount of GAAP violations, supports a strong inference of scienter. Additional indicia of scienter are: (1) the Individual Defendants’ receipt of internal reports, attendance at meetings and

extensive and daily involvement regarding Friedman's financial condition; (2) the codependent relationships amongst Friedman's, Crescent, Morgan Schiff and Cohen, including the conspiracy to defraud Capital Factors; (3) the motive to artificially inflate the Company's stock price in order to reap $79 million in proceeds from two public offerings so that the Company could refinance its credit facility and continue its meteoric expansion campaign; and (4) the motive to artificially inflate the Company's stock price in order to receive incentive compensation and so that millions of dollars in personal loans from the Company to Defendants Stinn and Brinkley would be forgiven.

A. The Magnitude of Friedman's Forthcoming Restatement

247. As a result of employing the numerous fraudulent accounting practices throughout the Class Period alleged herein, Friedman's was forced to announce that it will restate its publicly-filed financial statements for 2000-2003. As evidenced by the press releases stated above, as time has passed, the amount and the severity of the restatement has grown exponentially. Additionally, Defendant E&Y has withdrawn its unqualified audit opinions and Friedman's has informed the investing public that the financial statements of Crescent, which were reported with Friedman's financial results in the Company's SEC filings, are misstated and not to be relied upon.

248. The fact that Friedman's is going to restate its financial statements is an admission that: (i) the financial results originally issued during the Class Period and its public statements regarding those results were ***materially false and misleading when made***; and (ii) the financial statements reported during the Class Period were ***incorrect based on information available to Defendants at the time the results were originally reported***.

249. As recently noted by the SEC, "GAAP only allows a restatement of prior financial statements based upon information 'that existed at the time the financial statements were prepared,'" and "restatements should not be used to make any adjustments to take into account subsequent information that did not and could not have existed at the time the original financial statements were prepared."[4] The Accounting Principles Board ("APB") has defined the kind of "errors" that may be corrected through a restatement: "Errors in financial statements result from mathematical mistakes, mistakes in the application of accounting principles, or oversight or misuse of facts that ***existed at the time that the financial statements were prepared***." *See* APB 20 ¶¶7-13. The restatement at issue here was not due to a simple mathematical error, honest misapplication of a

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4 *In re Sunbeam Sec. Litig.*, No. 98-8258-Civ.-Middlebrooks (S.D. Fla. filed Jan. 31, 2002)(SEC Amicus Curiae Brief regarding Defendants Motion *In Limine* to Exclude Evidence of the Restatement and the Restatement Report).

standard or oversight, or instead, as alleged below, it was due to intentional or severely reckless misuse of the facts known at the time the financial statements were prepared and issued to the investing public.

250. The SEC has recently reiterated its position that, in its investigations of restated financial statements, it often finds that the persons responsible for the improper accounting acted with scienter:

> [T]he Commission often seeks to enter into evidence restated financial statement, and the documentation behind those restatements, in its securities fraud enforcement actions in order, inter alia, **to prove the falsity and materiality of the original financial statements [and] to demonstrate that persons responsible for the original misstatements acted with scienter...** *In re Sunbeam Sec. Litig.*, No. 98-8258-Civ.- Middlebrooks (S.D. Fla. filed Jan 31, 2002) (SEC Amicus Curiae Brief Regarding Defendants' Motion *In Limine* to Exclude Evidence of the restatement and Restatement Report).

251. The forthcoming restatement at issue in this case contains at least eight indicators of scienter:

i. *The type of restatement (misuse of the facts)* - The forthcoming restatement at issue was due to misuse of the facts. As alleged below, in many instances, Friedman's either knew what the correct accounting treatment was, and ignored it, or severely recklessly turned a blind eye to the information they possessed;

ii. *The size of the restatement* – although the amount of the restatement is not yet known, the Company has already revealed that the restatement will involve revenue, the allowance for uncollectible accounts, inventory, accounts payable as well as other liabilities, and Friedman's investment in Crescent. The restatement of these items will necessarily also involve a restatement of net income, earnings per share and retained earnings. The fact that Friedman's announced that it would restate its financial results on November 17, 2003, and has not yet done so reveals that the restatement will be massive;

iii. *The sheer number of improper accounting manipulations employed* − at least 5;

iv. *The duration over which the improper accounting was perpetrated* – As more fully detailed herein, Friedman's has stated that it will restate at least three years of financial results;

v. *The types of accounting manipulations employed* - As detailed herein, the improper accounting corrected by the forthcoming restatement did not occur as a result of good faith differences in accounting judgments, or interpretations of complicated or vague accounting rules. The accounting rules and precepts violated by Friedman's were long established, basic accounting standards and concepts, such as the most basic rule of recognizing revenue when all the conditions of the sale have been met. The accounting manipulations used by Friedman's are as old and basic as they come – such as the improper recording of inventory as an asset when it sits in a vault and will never be sold, or the scheme to inflate the Company's receivables so that it could obtain more financing from Capital Factors;

vi. The fact that the improper accounting was widespread, pervasive and systematic;

vii. The virtual unanimity with which the "errors," when finally announced to the investing public will show an inflation, not a reduction in net income and earnings; and

viii. The improper accounting was not a result of inexperienced accounting managers who did not understand accounting rules, nor can it be blamed solely on poor accounting controls – to the contrary, Friedman's financial officers knew what they were doing.

252. As evidenced in more detail above at ¶¶ 143-184, Defendants engaged in a pervasive scheme of accounting manipulations that contravened a number of GAAP provisions. Defendants knew or were severely reckless in not knowing that the manner in which the Company conducted its accounting contravened GAAP.

B. Defendants' Receipt of Internal Reports, Attendance at Meetings and Extensive and Daily Involvement Regarding Friedman's Financial Condition.

253. According to the V.P. of Operations, the Company, especially Bob Morris and Defendant Anderson, places an enormous amount of pressure for "comparable sales" increases. Friedman's tracked the comparable sales by percentage up or down versus the prior year for each store. Regional Vice Presidents would receive sales information daily at 2 p.m., 5 p.m. and 8 p.m. for each store in the region. Specifically, all Store Supervisors would gather the sales figures for their respective areas and report those numbers to the respective Vice Presidents of Operations at 2 p.m., 5 p.m. and 8 p.m. The Vice Presidents of Operations would then gather the information pertaining to their respective regions on sales, new accounts and collections. Subsequently, all Vice Presidents of

Operations reported their numbers to their peers on a daily conference call that occurred at 5 p.m.

254. Further evidence of the importance of "comparable sales" can be found in the information obtained from the Regional Partner. Depending on the time of day, if the store had not reacted its daily goal of "comparable sales," credit was approved for anyone who wanted it to ensure that the daily sales goal was achieved.

255. According to a former Store Partner, who was employed by Friedman's for approximately nine years from November 1994 through August 2003, the procedures regarding the operation of issuing credit was an internal and local control, but the overall responsibility, control and access was enforced by corporate headquarters. The Company would institute certain procedures, but actual practice was different and was "based on the concept of the credit runs the business and the business runs the credit." When business was slow, Friedman's employees were encouraged to open more accounts to obtain more business and to extend credit to Friedman's customers who would not otherwise qualify for credit. The Store Partner stated that "[w]e were more of a finance company first and a jewelry company second. In other words, the jewelry was the vehicle to motivate the financing." The three times of year in which there was a stronger push to

activate more credit accounts were February (for Valentine's Day), May (Mother's Day) and December (Christmas).

256. The Company created numerous internal reports on daily, weekly and bimonthly bases. According to the V.P. of Operations and Regional Partner, Daily Flash Reports were posted on the Company's intranet at 8 a.m. each day. The Daily Flash Report was "password coded," and all Friedman's employees from District Supervisors upward had access to the Daily Flash Report. The Daily Flash Report reported information on a company-wide basis and consisted of seven or eight segments, including tracking cash collections, cash collections by delinquent accounts and new accounts at the point of sale. Delinquent accounts were tracked by RCD stages zero through five, corresponding to the amount of time that the account was delinquent. As an example, RCD 0 was designated for an account that was up to 29 days late on payment while RCD 5 was designated for an account that was 180 plus days past due or bankrupt. According to the V.P. of Operations, "[e]verybody looks at the Flash Report first thing in the morning. If we had a bad day, it set the tone for the following day."

257. On a weekly basis, Friedman's created reports entitled "Weekly Ops Reports," which was distributed to all Company employees from District Supervisors upward. According to the V.P. of Operations, the Weekly Ops Report

listed net merchandise sales, net merchandise sales compared to projections, cash collections, cash collections versus prior year, the "charge business" and the "charge business" versus the prior year. As described in more detail below, the "charge business" was always the biggest topic of conversation during weekly conference calls to review the Weekly Ops Report.

258. Another report that was created on a weekly basis was an "A/R Aging Report," which was generated by a central computer at Friedman's headquarters and emailed to its recipients. According to a former Regional Vice President ("Regional V.P."), who was employed by Friedman's from 1995 to September 2001, the A/R Aging Report was broken down by store and showed the number of accounts, the age of the delinquency of such accounts and the dollar amount owed. After an account reached a four to five month delinquency, the account would be removed from the delinquency list. Delinquent accounts were also reported on a "P&L Listings" report.

259. According to a former Store Manager, who was employed with Friedman's from approximately February 2002 to April 2004, the Company's corporate office created a list on a monthly basis that set forth each store's delinquent accounts, which was sent via email over Friedman's extranet. The delinquent customer list was broken down into six stages, with each stage being

the number of months the account was delinquent. A delinquent account would remain on this list for a period of six months. If a store was unable to collect on an account, the account would be removed from the list and turned over to corporate headquarters for collection.

260. As stated by the Store Partner, Friedman's created a form by which credit guidelines were set. The form had a different credit ratings delineated by letters (A, B, C and D) that corresponded to levels of credit. However, actual practice deviated from the guidelines as set forth on the form. As an example, if the customer's credit grade was an A and the guidelines indicated that the customer's limit be set at $500, Friedman's would actually extend a credit limit as high as $1,000 or $1,500. If a certain Friedman's store were considered to be a "critical" score, the credit limit could vary without approval and then limits were approved up to $10,000. The higher amount of credit limit would go through various supervisory channels, which was done on a verbal basis and would take about 30 seconds to one minute to complete. According to the Store Partner, Friedman's conducted business with the lowest 5% of the credit bureau, which made these receivables extremely risky.

261. The Store Partner explained that if a customer failed to pay a Friedman's credit card bill and the account was charged off, the customer could

come back to the store and prove that he or she paid off the debt via a new credit check and then the customer could open a new account with Friedman's with a credit limit of $300-$500.

262. According to the Jewelry Buyer, Friedman's created inventory reports entitled "Ladders" reports. The Ladders reports were very detailed reports that set forth information from the IT department and contained several columns, including columns for inventory, inventory in credit and trade, sales and projected sales and orders. Each category of buyer did his or her own report, and all of the reports were available on the Company's extranet for everybody to view.

263. During the Class Period, Friedman's claimed to maintain a comprehensive, real-time computer system that monitored the Company's business on a daily basis and accurately calculated the Company's financials. For example, Friedman's 2002 Form 10-K provided the following, in part, under the heading "Systems and Controls":

> Our management information systems utilize an IBM AS/400-based system and customized software that was specifically designed for the retail jewelry industry. The system allows supervisors and senior management to review and analyze sales and credit activity by store, amount of sale, terms of sale and employees who approved the sale. Our entire credit extension and collection process is automated, and our system maintains all customer data to facilitate future credit transactions. Utilizing our information systems, senior management and field supervisors can monitor each store's and each employee's

> productivity and performance. The systems automatically provide a daily reconciliation of a store's transactions so that each Store Partner can investigate discrepancies on a timely basis. Overall, the systems provide information that enables us to monitor merchandise trends and variances in performance so that we can improve the efficiency in our inventory and personnel management.

264. The Company conducted conference calls on a weekly basis, at least two of which occurred on Monday morning. According to the V.P. of Operations, the first call took place at 9 a.m. and involved all of the Vice Presidents of Operations. The V.P. of Operations as well as the Finance Officer stated that a second call occurred at approximately 11:30 a.m. and involved numerous Friedman's executives, including Stuart Clifton, Defendants Stinn, Suglia and Anderson, all Vice Presidents of Operations, Division Presidents, Division Vice Presidents, Division Finance Officers and all Department Heads (including Human Resources, Credit and Marketing). Additional individuals that participated in the 11:30 a.m. conference call were Rose Myers, Bill Milligan and Dawn Smith. During the 11:30 a.m. conference call, the participants "would go over all the numbers for each of the markets" and would always discuss Friedman's allowance for bad debt.

265. According to the V.P. of Operations, during one such conference call, information was relayed regarding a potential "meltdown" at the Westgate Mall

store in Spartanburg, South Carolina. The V.P. of Operations informed the conference call participants that the store had approximately $1.2 million in accounts receivable, over half of which was uncollectible, and that this same store had written off $590,000 in uncollectible debt in the previous eight months. Upon receiving this information, Defendant Anderson went on an obscenity-laced diatribe, informing the V.P. of Operations to "not say there is a meltdown." The V.P. of Operations participated in many of these conference calls at Friedman's Savannah headquarters. As a result, the V.P. of Operations knew that the participants in these conference calls at the Company headquarters were stationed in the Company "Board Room" on the first floor of Friedman's headquarters.

266. According to the Regional V.P., Friedman's would conduct a conference call each week on Monday for every division, involving the Division President, Regional Vice Presidents and District Managers. At this meeting, the participants discussed the overview of the area, including whether any store had higher than average delinquencies, and if so, the reasons for such delinquencies and any possible remedies.

267. Also, the Regional V.P. participated in bi-monthly conference calls at the corporate level, which occurred on Mondays. Defendant Suglia and all of the Division Presidents were participants in these corporate level conference calls.

268. According to a former Vice President of Merchandising ("V.P. Merchandising"), who was employed with Friedman's from 1996 to 2000, at the end of every quarter, all of the Company's District Managers would meet at the Savannah headquarters for three or four days, "right before Brad would report earnings." Both Defendants Stinn and Suglia participated in these meetings, which took place in an area of the Company's headquarters referred to as the "bullpen." The V.P. of Merchandising would listen to these meetings as this individual's desk was located in the "bullpen," at which the participants would discuss each store in great detail, including each store's credit portfolio. According to the V.P. of Merchandising, "Bob [Morris] and Brad [Stinn] knew what was going on in every store down to the penny. Brad followed the stores in maniacal detail. There wasn't anything Brad didn't know was going on."

269. According to the Finance Officer, Friedman's conducted "Operational Review" meetings that took place in the middle of each month, immediately after the books closed for the preceding month. These Operational Review meetings had two prongs: (1) the Division President and the Division Finance Officer would have a meeting or conference call with Defendants Suglia and Mauro to discuss the Division financials for the preceding month; and (2) following this meeting, the Division Finance Officer and the Division President would conduct a conference

with the District Managers and all district Vice Presidents to discuss credit and trade merchandise. Defendant Suglia indicated that Friedman's needed to stop increasing the amount of credit and trade merchandise, but no actions were ever put into place to effect such a reduction.

270. Additionally, the Company admitted in its 2002 Form 10-K that its senior management, senior partners, regional vice presidents and division vice presidents interact on a daily basis to review individual store performance. The Company also admitted in its 2002 Form 10-K that its senior management has access to reports on the Company's financial condition on a daily basis.

C. The Codependent Relationships Amongst Friedman's, Crescent, Morgan Schiff and Cohen

271. As detailed at length above, Defendant Cohen owns Morgan Schiff, all of Friedman's Class B common stock and controls Crescent. The interrelationship amongst Friedman's, Crescent, Morgan Schiff and Cohen evidences that all of these companies and their respective management, especially Cohen, knew the true financial condition of one another. Additionally, Morgan Schiff received lucrative consulting fees to promote and/or recklessly disregard the falsity of the Company's Class Period misrepresentations and omissions.

272. Since 1994, Morgan Schiff has acted, and continues to act, as financial advisor to Friedman's for which it has received and continues to receive significant fees, a minimum of $400,000 per year plus expenses, on a non-accountable basis.

273. Through MS Jewelers, Defendant Cohen alone controls virtually all of the decisions made with respect to the Partnership, including the disposition and voting of the Company's Class B common stock. As a result of his control of the Class B common stock, Defendant Cohen can, without the concurrence of the remaining stockholders of the Company, elect 75% of the directors of the Company and control the outcome of votes by the Company's stockholders on major corporate transactions, including mergers, sales of substantial assets and going-private transactions.

274. In December 1994, the Company entered into a Financial Advisory Services Agreement with Morgan Schiff under which Morgan Schiff agreed to provide the Company with certain financial advisory services with respect to capital structure, business strategy and operations, budgeting and financial controls, and mergers, acquisitions and other similar transactions. The Company also agreed to indemnify Morgan Schiff against any losses associated with the Financial Advisory Services Agreement.

275. Since 1994, Morgan Schiff has acted, and continues to act, as financial advisor to the Company for which it has received and continues to receive significant fees of a minimum of $400,000 per year plus expenses on a non-accountable basis.

276. For example, in fiscal year 1999, the Company accrued estimated costs of $1 million for services provided by Morgan Schiff associated with a refinancing, Friedman's acquisition of a purchase warrant and a guarantee of Crescent's debt. Additionally, in fiscal year 2002, the Company paid $2.4 million in management fees, transaction fees and related expenses to Morgan Schiff under the Financial Advisory Services Agreement in connection with its February 2002 sale of Class A common stock, its August 2002 credit facility refinancing and an investment in Crescent.

277. Furthermore, as detailed above, Cosmopolitan, Friedman's and Crescent conspired to defraud Capital Factors, according to the Capital Factors complaint. Capital Factors alleges that Cosmopolitan, Friedman's and Crescent participated in a scheme to misrepresent the balance of Cosmopolitan's accounts receivable, the effect of which was to induce Capital Factors to continue to advance funds to Cosmopolitan that were not sufficiently collateralized.

278. Capital Factors also alleges that Friedman's and Crescent knowingly made improper payments on accounts with Cosmopolitan directly to Cosmopolitan rather than to Capital Factors as was required under the terms of the invoice. According to the Capital Factors complaint, Robert Morris, the sales manager for Cosmopolitan during the time at issue in the Capital Factors suit, was a Friedman's employee and a Crescent director. The Capital Factors complaint details numerous transactions in which Friedman's and Crescent intentionally misrepresented the accounts payable statements it submitted to Cosmopolitan in an effort to hide the true amount due to Capital Factors on the assignments from Cosmopolitan.

D. The Motive to Commit Fraud to Raise Capital in the Secondary Offerings

1. The February 2002 Offering

279. As stated in greater detail below, the Company conducted a secondary offering in February 2002, which resulted in proceeds of $33 million, pursuant to the Registration Statement and Prospectus Supplements filed with the SEC (the "February 2002 Offering"). The February 2002 Offering was significant as it increased Friedman's outstanding Class A common stock by 28%.

280. The Company was motivated to conceal its true financial condition in the context of the February 2002 Offering because it needed the proceeds from the

February 2002 Offering, *inter alia*, to refinance the Company's $65.7 million credit facility that came due in September 2002, to refinance its guarantor obligations to Crescent, forgive personal loans to several Defendants, see ¶¶288-298 below, and finance the Company's continued acquisition and store opening campaign. Indeed, the February 6, 2002 Prospectus Supplement for the February 2002 Offering touted the Company's historical growth and the need to foster its current expansion campaign.

281. Additionally, shortly after the February 2002 Offering, on August 18, 2002, the Company reported that it had nearly tripled its credit facility as a result of the February 2002 Offering. The Company announced, "we entered into a new three-year $150 million secured revolving credit facility, which replaced our three-year $67.5 million senior secured revolving credit facility that was scheduled to expire on September 15, 2002."

282. The Company also reported, on August 18, 2002, that the new credit facility enabled Friedman's to: (1) terminate its guarantee of Crescent's previous $112.5 million credit facility; (2) invest $85 million in Crescent; and (3) acquire $50 million in Crescent Series A preferred stock. Furthermore, the Company reported that the new financing enabled Crescent to replace its expiring credit facility with a new three-year $50 million revolving credit facility.

283. In a November 6, 2002 press release, the Company stressed the financial importance of the February 2002 Offering and the resultant restructuring, stating, in part: "we significantly strengthened our balance sheet with year-over-year debt reduction of $69 million . . . we successfully restructured and refinanced our senior bank facility, eliminating the Crescent guarantee and solidly capitalizing Crescent with a direct investment."

2. The September 2003 Offering

284. As stated in greater detail below, the Company conducted another secondary offering in September 2003. In fact, the Company completed the offering of 3,100,000 shares of Class A common stock at $15.00 per share, resulting in proceeds of $43.1 million (the "September 2003 Offering"), ten days after the SEC opened an informal investigation into Friedman's financial activities. The September 2003 Offering was significant as it increased Friedman's outstanding Class A common stock by 18%.

285. The Company was motivated to conceal its true financial condition in the context of the September 2003 Offering because, as documented in the Company's September 19, 2003 Prospectus Supplement, it needed the proceeds from the offering, *inter alia*, to "fund new store openings," "fund acquisitions" and "repay a portion of the debt outstanding under its credit facility or other

indebtedness." Defendants also used a portion of the September 2003 Offering proceeds to pay down its credit facility and to continue providing financial support to its affiliate, Crescent.

286. The terms of the February 2002 and September 2003 Offerings would have been negatively and materially affected had the market known the truth regarding Friedman's accounting manipulations, as detailed in ¶143-184 above, which resulted in the artificial inflation of the Company's revenue, earnings, net income and stock price.

287. With respect to the September 2003 Offering, analysts were dismayed that it occurred less than two months before the Company's revelation that it drastically understated its allowance for bad debts. For example, a November 28, 2003 Atlanta Journal-Constitution article provided,

> "Something is definitely very wrong here," said Paul Resnik, an analyst who covers Friedman's for J.M. Dutton & Associates, an investment research firm headquartered in San Francisco.
>
> * * *
>
> Most surprising about the bad debt issue was that it surfaced less than two months after Friedman's sold 3.1 million shares of common stock, Resnik said.
>
> "When people do any offering, the numbers get looked at by auditors and lawyers," he pointed out. "Why was this not discovered before?"

E. Motive Based Upon Incentive Compensation and Loan Forgiveness

288. The Proxy Statement filed on Form 14A on January 22, 2003 ("2002 Proxy Statement"), contained summary information concerning compensation for the fiscal years 2002, 2001 and 2000 earned by (i) the Chief Executive Officer of the Company; and (ii) each of the other four most highly compensated executive officers of the Company whose total salary and bonus for the fiscal year ended September 28, 2002, exceeded $100,000.

SUMMARY COMPENSATION TABLE

ANNUAL COMPENSATION					LONG TERM COMPENSATION AWARDS
NAME	YEAR	SALARY	BONUS	OTHER ANNUAL COMPENSATION	UNDERLYING OPTIONS
Bradley J. Stinn	2002	$550,000	$352,000	$124,396	$100,000
	2001	$440,356	--	$129,806	$109,000
	2000	$400,000	$200,000	$149,304	--
Sterling B. Brinkley	2002	$425,000	$272,000	$64,751	$50,000
	2001	$319,231	--	$68,464	$59,000
	2000	$300,000	$100,000	$87,553	--
Douglas Anderson	2002	$375,000	$166,667	$17,156	--
	2001	$14,423	--	--	$150,000
Victor M. Suglia	2002	$215,000	$137,000	$42,117	$20,000
	2001	$210,994	--	--	$55,000
	2000	$190,000	$50,000	--	--

289. The other compensation for Defendant Stinn is comprised of the following: (i) a housing allowance of $42,000 in each of fiscal 2002, 2001, and 2000; (ii) an automobile allowance of $17,919, $17,400, and $17,550 in fiscal 2002, 2001, and 2000, respectively; (iii) annual interest forgiveness on an incentive loan of $20,850, $37,350, and $46,800 in fiscal 2002, 2001, and 2000, respectively; (iv) an annual reimbursement for the payment of taxes on the interest forgiveness of $18,453, $33,056, and $42,954 in fiscal 2002, 2001, and 2000, respectively; (v) principal forgiveness on an incentive stock purchase loan of $12,500 in fiscal 2002; and (vi) interest forgiveness on a stock purchase loan of $12,674 in fiscal 2002.

290. The other annual compensation for Defendant Brinkley is comprised of the following: (i) annual interest forgiveness on an incentive loan of $20,850, $37,350, and $46,800 in fiscal 2002, 2001, and 2000, respectively; (ii) an annual reimbursement for the payment of taxes on the interest forgiveness of $17,369, $31,114, and $40,753 in fiscal 2002, 2001, and 2000, respectively; (iii) an automobile allowance of $1,358 in fiscal 2002; (iv) principal forgiveness on an incentive stock purchase loan of $12,500 in fiscal 2002; and (v) interest forgiveness on a stock purchase loan of $12,674 in fiscal 2002.

291. Defendant Anderson's bonus in 2002 is partially comprised of principal forgiveness on an incentive loan of $66,667.

292. Defendant Suglia's other annual compensation for 2002 is partially comprised of (iii) principal forgiveness on an incentive stock purchase loan of $7,500 and (iv) annual interest forgiveness on a stock purchase loan of $7,604.

293. Defendants Stinn, Brinkley and Suglia also received the following options:

OPTION GRANTS IN LAST FISCAL YEAR
INDIVIDUAL GRANTS

NAME	NUMBER OF SECURITIES UNDERLYING OPTIONS/SARS GRANTED (#)	PERCENT OF TOTAL OPTIONS GRANTED TO	EXERCISE OR BASE PRICE ($/SH)	EXPIRATION DATE
Bradley J. Stinn	100,000	23.28%	$7.62	11/6/11
Sterling B. Brinkley	50,000	11.64%	$7.62	11/6/11
Victor M. Suglia	20,000	4.66%	$7.62	11/6/11

294. Additionally, the 2002 Proxy Statement stated that the Company agreed to make a payment of $30,000 to the Chairman of the Audit Committee, Defendant Mark Pickup, in recognition of the time spent by the Chairman of the Audit Committee in connection with the Company's August 2002 credit facility refinancing and investment in Crescent Jewelers.

295. As further incentive to enhance the value of the Company for the benefit of its stockholders, in October 1994, when the Class A Common Stock price was $16.38, the Company adopted an incentive plan that provided each of Defendants Brinkley and Stinn a loan in the amount of $1.5 million, the repayment of which is forgiven upon the attainment of specific targets for the market price of the Company's Class A common stock ranging from $22.50 to $32.50. The plan was structured such that if the Company is able to achieve nearly 100% appreciation in its stock price within a designated period, the entire amount of all advances to Defendants Brinkley and Stinn will be forgiven and related tax consequences will be paid by the Company.

296. The incentive features of the loans provide that: (i) as long as Defendants Brinkley or Stinn are employed by the Company on the date on which interest is due on the loans, the interest will be forgiven; (ii) a percentage of the outstanding principal of the loans will be forgiven upon the attainment of certain targets for the market price of the Company's Class A common stock; and (iii) the Company will pay any taxes due as the result of the forgiveness of interest and principal.

297. According to the V.P. of Merchandising, former CFO John Call discussed with the V.P. of Merchandising that Call would try to “gross it up,”

meaning he would have to figure out a method by which to provide Defendant Stinn with additional bonus compensation so that Defendant Stinn would not have to pay taxes on the loan forgiveness. Additionally, Defendant Morgan Schiff provided a loan to Defendant Stinn and the term of the loan provided that Defendant Morgan Schiff would forgive the loan when Friedman's stock achieved a price of $35 per share.

298. According to the Regional V.P., a "P&L Goal" was set at the beginning of each cycle, with each cycle consisting of 60 days. The P&L Goal included reducing the dollar amount of delinquent accounts in the given cycle. The Regional V.P. stated that if the pre-set "P&L Goal" was achieved, a $500 to $750 bonus would be given.

299. Defendants were also motivated to artificially inflate the price of Friedman's stock in order to receive long-term incentive compensation. The 2002 Proxy Statement states that long-term incentive compensation is given to certain Friedman's employees according to the 1999 long-term incentive plan as stated in the 1999 Proxy Statement filed on Form 14A with the SEC on January 27, 1999 ("1999 Proxy Statement"). The 1999 Proxy Statement sets forth the following performance-based criteria used by the Compensation Committee to determine the amount of long-term compensation awarded:

> The Compensation Committee may determine that any Award will be calculated solely on the basis of (i) the achievement by the Company or a parent or subsidiary of a specified target return, or target growth in return, on equity or assets; (ii) the Company, parent or subsidiary's stock price; (iii) the achievement by an individual or a business unit of the Company, parent or subsidiary of a specified target or target growth in revenues, net income or earnings per share; (iv) the achievement of objectively determinable goals with respect to service or product delivery, service or product quality, customer satisfaction, meeting budgets and/or retention of employees; or (v) any combination of the goals set forth in (i) through (iv) above.

300. As indicated above, these Defendants acted with scienter throughout the Class Period.

NO SAFE HARBOR

301. The federal statutory safe harbor provided for forward-looking statements under certain circumstances does not apply to any of the allegedly false statements pleaded in this Complaint. Further, none of the statements pleaded herein which were forward-looking statements were identified as "forward-looking statements" when made. Nor was it stated that actual results "could differ materially from those projected." Nor were the forward-looking statements pleaded accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from the statements made therein. Defendants are liable for the forward-looking statements pleaded because, at the time each of those forward-looking statements was made, the speaker knew

the forward-looking statement was false and the forward-looking statement was authorized and/or approved by an executive officer of Friedman's who knew that those statements were false when made.

APPLICABILITY OF PRESUMPTION OF RELIANCE:
FRAUD-ON-THE-MARKET DOCTRINE

302. Friedman's common stock traded in an efficient market on the NASDAQ National Market System and the New York Stock Exchange during a substantial part of the Class Period. The average daily volume of Friedman's shares during the Class Period was more than 97,450 shares, based on Friedman's stock price history. The total number of shares traded during the 1148 trading days of the Class Period was 111,893,084.

303. During the Class Period, Friedman's was followed and reported on by a number of major market analysts who issued publicly available analysts' reports about the Company:

304. During the Class Period, there were at least 20 market makers for Friedman's stock.

305. During the Class Period, Friedman's met the eligibility requirements for registering new equity securities on SEC Form S-3, as set forth in ¶IA(1)-(8) of

the General Instructions of Form S-3. The Company filed an S-3 Registration Statement on December 28, 2001.

306. By virtue of the foregoing, the market for Friedman's securities was efficient during the Class Period. Therefore, reliance on the Defendants' fraudulent and misleading statements is presumed under the fraud-on-the-market doctrine.

COUNT I

Against Friedman's, The Individual Defendants And E&Y On Behalf Of The Class For Violations Of Section 10(b) Of The Exchange Act and Rule 10(b)(5) Promulgated Thereunder

307. Lead Plaintiffs repeat and reallege the allegations set forth as though fully set forth herein.

308. This Count is brought pursuant to Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5, on behalf of all Lead Plaintiffs and the Section 10(b) Class, against Friedman's, the Individual Defendants and E&Y.

309. During the Class Period, Friedman's, the Individual Defendants and E&Y carried out a plan, scheme and course of conduct which was intended to and, throughout the Class Period, did: (i) deceive the investing public, including Lead

Plaintiffs and other Class members, as alleged herein; (ii) artificially inflate and maintain the market price of Friedman's common stock; and (iii) cause Lead Plaintiffs and other members of the Class to purchase Friedman's stock at artificially inflated prices. In furtherance of this unlawful scheme, plan and course of conduct, Friedman's, the Individual Defendants and E&Y took the actions set forth herein.

310. Friedman's, the Individual Defendants and E&Y: (a) employed devices, schemes, and artifices to defraud; (b) made untrue statements of material fact and/or omitted to state material facts necessary to make the statements not misleading; and (c) engaged in acts, practices and a course of business which operated as a fraud and deceit upon the purchasers of the Company's common stock in an effort to maintain artificially high market prices for Friedman's common stock in violation of Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder. Friedman's, the Individual Defendants and E&Y are sued as primary participants in the wrongful and illegal conduct charged herein, as alleged herein.

311. In addition to the duties of full disclosure imposed on Friedman's, the Individual Defendants and E&Y as a result of their making of affirmative statements and reports, or participation in the making of affirmative statements and

reports, to the investing public, Friedman's, the Individual Defendants and E&Y had a duty to promptly disseminate truthful information that would be material to investors. The undisclosed adverse information concealed by Friedman's, the Individual Defendants and E&Y during the Class Period is the type of information which, because of SEC regulations, regulations of the national stock exchanges and customary business practice, is expected by investors and securities analysts to be disclosed and is known by corporate officials and their legal and financial advisors to be the type of information which is expected to be and must be disclosed.

312. Friedman's, the Individual Defendants and E&Y, individually and in concert, directly and indirectly, by the use, means or instrumentalities of interstate commerce and/or of the mails, engaged and participated in a continuous course of conduct to conceal adverse material information about the business and operations of Friedman's and its affiliates, as specified herein. Friedman's, the Individual Defendants and E&Y employed devices, schemes and artifices to defraud, while in possession of material adverse non-public information and engaged in acts, practices, and a course of conduct as alleged herein in an effort to assure investors of Friedman's value and performance and continued substantial growth, which included the making of, or the participation in the making of, untrue statements of material facts and omitting to state material facts necessary in order to make the

statements made about Friedman's, its affiliates and their business operations in the light of the circumstances under which they were made, not misleading, as set forth more particularly herein, and engaged in transactions, practices and a course of business which operated as a fraud and deceit upon the purchasers of Friedman's common stock during the Class Period.

313. Friedman's, the Individual Defendants and E&Y had actual knowledge of the misrepresentations and omissions of material facts set forth herein, or acted with severe reckless disregard for the truth in that they failed to ascertain and to disclose such facts, even though such facts were available to them. Friedman's, the Individual Defendants' and E&Y's material misrepresentations and/or omissions were done knowingly or severely recklessly and for the purpose and effect of concealing Friedman's operating condition and deteriorating and adverse business prospects from the investing public and supporting the artificially inflated price of its common stock. As demonstrated by Friedman's, the Individual Defendants' and E&Y's misstatements of the Company's business, operations and earnings throughout the Class Period, Friedman's, the Individual Defendants and E&Y if they did not have actual knowledge of the misrepresentations and omissions alleged, were severely reckless in failing to obtain such knowledge by

deliberately refraining from taking those steps necessary to discover whether those statements were materially false or misleading.

314. As a result of the dissemination of the materially false and misleading information and failure to disclose material facts, as set forth above, the market price of Friedman's common stock was artificially inflated during the Class Period. In ignorance of the fact that the market price of Friedman's common stock was artificially inflated, and relying directly or indirectly on the materially false and misleading statements made by Friedman's, the Individual Defendants and E&Y, or upon the integrity of the market in which the securities trade, and/or on the absence of material adverse information that was known to or recklessly disregarded by Friedman's, the Individual Defendants and E&Y but not disclosed in public statements by Friedman's, the Individual Defendants and E&Y during the Class Period, Lead Plaintiffs and the other members of the Class acquired Friedman's common stock during the Class Period at artificially high prices and were damaged thereby.

315. At the time of said misrepresentations and omissions, Lead Plaintiffs and the other members of the Class were ignorant of their falsity, and believed them to be true. Had Lead Plaintiffs and the other members of the Class and the marketplace known of the true financial condition and business prospects of

Friedman's, which were not disclosed by Friedman's, the Individual Defendants and E&Y, Lead Plaintiffs and other members of the Class would not have purchased or otherwise acquired their Friedman's common stock during the Class Period, or, if they had acquired such common stock during the Class Period, they would not have done so at the artificially inflated prices which they paid.

316. By virtue of the foregoing, Friedman's, the Individual Defendants and E&Y have violated Section 10(b) of the Exchange Act, and Rule 10b-5 promulgated thereunder.

317. As a direct and proximate result of Friedman's, the Individual Defendants' and E&Y's wrongful conduct, Lead Plaintiffs and the other members of the Class suffered damages in connection with their purchases of the Company's common stock during the Class Period.

COUNT II

Against The Individual Defendants And Control Person Defendants On Behalf Of The Class For Violations Of Section 20(a) Of The Exchange Act

318. Lead Plaintiffs repeat and reallege each and every allegation contained above as if alleged in full herein.

319. This Count is brought pursuant to Section 20(a) of the Exchange Act, 15 U.S.C. § 78t(a), on behalf of the Lead Plaintiffs and the Class, against the Individual Defendants and Control Person Defendants.

320. The Individual Defendants and Control Person Defendants acted as controlling persons of Friedman's within the meaning of Section 20(a) of the Exchange Act as alleged herein. By virtue of their high-level positions and/or their ownership and contractual rights, participation in and/or awareness of the Company's operations and/or intimate knowledge of the Company's finances and business prospects, the Individual Defendants and Control Person Defendants had the power to influence and control and did influence and control, directly or indirectly, the decision-making of the Company, including the content and dissemination of the various statements which Lead Plaintiffs allege were materially false and misleading. The Individual Defendants and Control Person Defendants were provided with or had unlimited access to copies of the Company's reports, press releases, public filings and other statements alleged by Lead Plaintiffs to be misleading prior to and/or shortly after these statements were issued and had the ability to prevent the issuance of the statements or cause the statements to be corrected.

321. In particular, each of the Individual Defendants and Control Person Defendants had direct and supervisory involvement in the day-to-day operations of the Company and/or control over major corporate decision and policy making, and therefore, is presumed to have had the power to control or influence the particular transactions giving rise to the securities violations as alleged herein, and exercised the same. The Individual Defendants culpably participated in the commission of the wrongs alleged herein.

322. As set forth above, Friedman's, the Individual Defendants and E&Y each violated Section 10(b) and Rule 10b-5 by their acts and omissions as alleged in this Complaint. By virtue of their positions as controlling persons, the Individual Defendants and Control Person Defendants are liable pursuant to Section 20(a) of the Exchange Act. As a direct and proximate result of the Individual Defendants and Control Person Defendants' wrongful conduct, Lead Plaintiffs and other members of the Section 10(b) Class suffered damages in connection with their purchases of Friedman's common stock during the Class Period.

323. By reason of such wrongful conduct, the Individual Defendants and Control Person Defendants are liable pursuant to Section 20(a) of the Exchange Act.

VI. THE FALSE AND MISLEADING REGISTRATION STATEMENT AND PROSPECTUS SUPPLEMENTS

324. On December 28, 2001, the Company filed a Form S-3 Shelf Registration Statement (the "Registration Statement") with the SEC. The Registration Statement was for an offering of an indeterminate amount of Class A common stock, preferred stock, warrants, debt securities and guarantees of debt securities for up to a total of $200 million.

325. The Registration Statement stated the following:

> The SEC allows us to "incorporate by reference" additional information into the prospectus. This means that we can disclose important information about us to you by referring you to another document that we have filed separately with the SEC. The information that we incorporate by reference is an important part of this prospectus. Information that we later file with the SEC will automatically update and supercede this information. We incorporate the documents listed below, as well as any future documents we file with the SEC (File No. 000-22356) under Sections 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act of 1934 prior to the termination of the offering of our common stock under this prospectus:

326. Friedman's engaged in a secondary offering for its Class A common stock in February 2002 on a firm commitment basis. In order to update the Company's financial information from the December 2001 S-3 Shelf Registration Statement, Friedman's filed Prospectus Supplements on Form 424(b)(5) on January 24, 2003 and February 6, 2002 ("the 2002 Prospectus Supplements"). The

2002 Prospectus Supplements offered 3,750,000 shares of Class A common stock at a price of $9.50 per share. The Company also granted the underwriters an option to purchase up to 562,500 additional shares of Class A common stock to cover over-allotments.

327. The 2002 Prospectus Supplement issued on February 6, 2002 states the following:

> The SEC allows us to "incorporate by reference" additional information into this prospectus. This means that we can disclose additional important information about us to you by referring you to another document that we have filed separately with the SEC. The information that we incorporate by reference is an important part of this prospectus. Information that we file later with the SEC will automatically update and supersede the information contained in this prospectus. We incorporate by reference the documents listed below, as well as any future documents we file with the SEC (File No. 000-22356) under Sections 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act of 1934 prior to the termination of the offering of our common stock under this prospectus:
>
> - Our Annual Report on Form 10-K for the fiscal year ended September 29, 2001, which was filed on December 28, 2001;
>
> - The description of our Class A common stock set forth in our registration statement on Form 8-A filed under Section 12 of the Exchange Act, and any amendment or report filed for the purpose of updating that description.

328. The 2002 Prospectus Supplements incorporated by reference the Company's 2000 and 2001 Form 10-K's. As such, the information contained in these SEC filings "is considered to be a part of" the September Prospectus.

329. The Registration Statement and the 2002 Prospectus Supplements contained materially false and misleading statements because the Company: (1) failed to write down an impairment for its investment in Crescent, as set forth in ¶¶143-150; (2) improperly recognized revenue, as set forth in ¶¶151-155; (3) understated its allowance for uncollectible accounts, as set forth in ¶¶156-172; (4) overstated inventory, as set forth in ¶¶173-176; and (5) was involved in a scheme, along with Crescent and Cosmopolitan, to defraud Capital Factors, which resulted in an understatement of Friedman's accounts payable, as stated in ¶¶177-184, all of which contravened the mandates of GAAP.

330. Subsequently, Friedman's engaged in another secondary offering on a firm commitment basis for its Class A common stock in September 2003. In order to update the Company's financial information from the December 2001 S-3 Shelf Registration Statement, Friedman's filed Prospectus Supplements on Form 424(b)(5) on August 30, 2003 and September 19, 2003 ("the 2003 Prospectus Supplements"). The 2003 Prospectus Supplement offered 3,100,000 shares of Class A common stock at an offering price of $15 per share. Friedman's has also

granted the underwriters a 30-day option to purchase up to an additional 465,000 shares of Class A common stock to cover any over-allotments.

331. The 2003 Prospectus Supplement issued on September 19, 2003 states the following:

> The SEC allows us to "incorporate by reference" additional information into this prospectus. This means that we can disclose additional important information about us to you by referring you to another document that we have filed separately with the SEC. The information that we incorporate by reference is an important part of this prospectus. Information that we file later with the SEC will automatically update and supersede the information contained in this prospectus. We incorporate by reference the documents listed below, as well as any future documents we file with the SEC (File No. 000-22356) under Sections 13(a), 13(c) 14 or 15(d) of the Securities Exchange Act of 1934 prior to the termination of the offering of our common stock under this prospectus:
>
> - Our Annual Report on Form 10-K for the fiscal year ended September 29, 2001, which was filed on December 28, 2001
>
> - The description of our Class A common stock set forth in our registration statement on Form 8-A filed under Section 12 of the Exchange Act, and any amendment or report filed for the purpose of updating that description.

332. The 2003 Prospectus Supplements incorporated by reference the Company's 2001 and 2002 Form 10-K's as well as the Form 10-Q's for each fiscal quarter in 2002 and 2003. As such, the information contained in these SEC filings "is considered to be a part of" the September Prospectus.

333. The Registration Statement and the 2003 Prospectus Supplements contained materially false and misleading statements because the Company: (1) failed to write down an impairment for its investment in Crescent, as set forth in ¶¶143-150; (2) improperly recognized revenue, as set forth in ¶¶151-155; (3) understated its allowance for uncollectible accounts, as set forth in ¶¶156-172; (4) overstated inventory, as set forth in ¶¶173-176; and (5) was involved in a scheme, along with Crescent and Cosmopolitan, to defraud Capital Factors, which resulted in an understatement of Friedman's accounts payable, as stated in ¶¶177-184, all of which contravened the mandates of GAAP.

COUNT III

Against Defendant Friedman's, the Individual Defendants (except for Defendants Anderson, Mauro and Cartoon), the Director Defendants, the Underwriter Defendants and E&Y On Behalf Of The Section 11 Subclass For Violations Of Section 11 Of The Securities Act

334. The Section 11 Subclass repeats and realleges each and every allegation contained above as if alleged in full herein, except that for purposes of this count, Plaintiff Bortel expressly excludes and disclaims any allegation that could be construed as alleging fraud or intentional or reckless misconduct, as this count is based solely on claims of strict liability and/or negligence under the Securities Act.

335. This Count is brought pursuant to Section 11 of the Securities Act, 15 U.S.C. § 77k, against Defendant Friedman's, the Individual Defendants (except for Defendants Anderson, Mauro and Cartoon), the Director Defendants, the Underwriter Defendants and E&Y and does not sound in fraud, on behalf of the Section 11 Subclass who purchased Friedman's common stock pursuant to the February 6, 2002 and September 19, 2003 public offerings and is represented by Plaintiff Allan Bortel.

336. The Registration Statement and Prospectus Supplements were materially false and misleading, contained untrue statements of material facts, and omitted to state other facts necessary to make the statements made not misleading, as set forth above.

337. Friedman's is the registrant for the public offering. The Defendants named herein were responsible for the contents and dissemination of the Registration Statement and Prospectus Supplements and caused their filing with the SEC.

338. Plaintiff Bortel purchased shares of Friedman's pursuant to or traceable to the Registration Statement.

339. As issuer of the shares, Friedman's is strictly liable to the Section 11 Subclass for the misstatements and omissions contained in the Registration Statement and Prospectus Supplements.

340. Each of the Individual Defendants and Director Defendants named in this Count signed the Registration Statement and/or the Prospectus Supplements.

341. None of the Defendants named herein made a reasonable investigation or possessed reasonable grounds for the belief that the statements contained in the Registration Statement/Prospectus Supplements were true and without omissions of any material facts and were not misleading.

342. Each Defendant issued, caused to be issued and participated in the issuance of materially false and misleading written statements to the investing public that were contained in the Registration Statement/Prospectus Supplements, which misrepresented or failed to disclose, *inter alia*, the facts alleged herein. By reasons of the conduct herein alleged, each Defendant violated Section 11 of the Securities Act.

343. Members of the Section 11 Subclass purchased or otherwise acquired Friedman's common stock issued pursuant to, or traceable to, the Registration Statement/Prospectus Supplements.

344. The Section 11 Subclass has sustained damages. The value of Friedman's common stock has declined substantially subsequent to and due to Defendants' violations.

345. At the times they purchased Friedman's common stock through the February 6, 2002 and September 19, 2003 public offerings, the Section 11 Subclass members were without knowledge of the facts concerning the wrongful conduct alleged herein. Less than two years have elapsed from the time that the Section 11 Subclass discovered or reasonably could have discovered the facts upon which this Complaint is based. Less than five years have elapsed from the time that the securities upon which this Count is brought were bona fide offered to the public to the time the Section 11 Subclass filed their Complaint.

COUNT IV

Against Defendant Friedman's and the Underwriter Defendants (except for Defendant ABN AMRO Rothschild LLC) For Violations Of Section 12(a)(2) Of The Securities Act

346. Plaintiff Bortel incorporates all the allegations contained in above, except that for purposes of this count, Plaintiff Bortel expressly excludes and disclaims any allegation that could be construed as alleging fraud or intentional or reckless misconduct, as this count is based solely on claims of strict liability and/or negligence under the Securities Act.

347. This Count is brought by Plaintiff Allan Bortel against Defendants Friedman's and the Underwriter Defendants pursuant to Section 12(a)(2) of the Securities Act on behalf of all members of the Section 12(a)(2) Subclass that purchased Friedman's shares pursuant to the September 19, 2003 offering.

348. Friedman's and the Underwriters Defendants were sellers and offerors of the shares offered pursuant to the Registration Statement and September 19, 2003 Prospectus.

349. The Registration Statement and September 19, 2003 Prospectus contained untrue statements of material facts, omitted to state other facts necessary to make the statements made not misleading, and concealed and failed to disclose material facts. Defendants' actions of solicitation included participating in the preparation of the false and misleading Registration Statement and September 19, 2003 Prospectus.

350. Friedman's and the Underwriter Defendants owed to the purchasers of Friedman's shares, including Plaintiff Bortel and other Section 12(a)(2) Subclass members, the duty to make a reasonable and diligent investigation of the statements contained in the Registration Statement and September 19, 2003 Prospectus, ensure that such statements were true and ensure that there was no

omission of material fact required to be stated in order to make the statements contained therein not misleading.

351. Plaintiff Bortel and other members of the Section 12(a)(2) Subclass purchased or otherwise acquired Friedman's shares pursuant to the defective Registration Statement and September 19, 2003 Prospectus. Plaintiff Bortel did not know, or in the exercise of reasonable diligence could not have known, of the untruths and omissions contained in the Registration Statement and September 19, 2003 Prospectus.

352. Plaintiff Bortel, individually and representatively, hereby offers to tender to Friedman's and the Underwriter Defendants those securities which Plaintiff Bortel and other Section 12(a)(2) Subclass members continue to own, on behalf of all members of the Section 12(a)(2) Subclass who continue to own such securities, in return for the consideration paid for those securities together with interest thereon. Section 12(a)(2) Subclass members who have sold their Friedman's shares are entitled to rescissory damages.

353. By reason of the conduct alleged herein, Friedman's and the Underwriter Defendants violated, and/or controlled a person who violated, Section 12(a)(2) of the Securities Act. Accordingly, Plaintiff Bortel and members of the Section 12(a)(2) Subclass who hold Friedman's shares purchased in the September

19, 2003 offering have the right to rescind and recover the consideration paid for their Friedman's shares and hereby elect to rescind and tender their Friedman's shares to Friedman's and the Underwriter Defendants sued herein. Plaintiff Bortel and the Section 12(a)(2) Subclass members who have sold their Friedman's shares are entitled to rescissory damages.

354. Less than five years elapsed between the time that the securities upon which this Count is brought were sold to the public and the time of the filing of this action. Less than two years elapsed from the time when Plaintiff Bortel discovered or reasonably could have discovered the facts upon which this Count is based to the time of the filing of this action.

COUNT V

Against The Individual Defendants (except for Defendant Cartoon) And Control Person Defendants For Violations Of Section 15 Of The Securities Act

355. Plaintiff Bortel incorporates all the allegations contained in above, except that for purposes of this count, Plaintiff Bortel expressly excludes and disclaims any allegation that could be construed as alleging fraud or intentional or reckless misconduct, as this count is based solely on claims of strict liability and/or negligence under the Securities Act. This count is brought by Plaintiff Allan Bortel.

356. This Count is brought pursuant to Section 15 of the Securities Act, 15 U.S.C. § 77o, against the Individual Defendants and the Control Person Defendants.

357. The Individual Defendants and Control Person Defendants were control persons of Friedman's by virtue of their positions as director and/or senior officer of Friedman's and/or by virtue of their status as a major shareholder of the Company.

PRAYER FOR RELIEF

WHEREFORE, Lead Plaintiffs and Plaintiff Bortel, on behalf of themselves and the Class, pray for judgment as follows:

A. declaring this action to be a plaintiff class action properly maintained pursuant to Rule 23(a) and (b)(3) of the Federal Rules of Civil Procedure;

B. awarding Lead Plaintiffs, Plaintiff Bortel and other members of the Class damages together with interest thereon;

C. awarding Lead Plaintiffs, Plaintiff Bortel and other members of the Class their costs and expenses of this litigation, including reasonable attorneys' fees, accountants' fees and experts' fees and other costs and disbursements; and

D. awarding Lead Plaintiffs, Plaintiff Bortel and other members of the Class such other and further relief as may be just and proper under the circumstances.

JURY TRIAL DEMANDED

Lead Plaintiffs hereby demand a trial by jury.

Dated: September 23, 2004

Respectfully submitted,

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