

The background features a large, stylized blue graphic of a hand holding a CD. A circular inset in the center shows a store interior with shelves of products. The overall color scheme is dominated by shades of blue and teal.

Trans World Entertainment
Annual Report 2002

Change. Challenge. Opportunity.



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We welcome **change**

Where others see **challenge**

We see **opportunity**



Robert J. Higgins
Chairman and CEO
Trans World Entertainment

2002 was a disappointing year – for our company and for the retail entertainment industry in general.

There were many challenges last year. The growth of music piracy – CD burning, file-sharing and digital downloading – contributed to a continuing decline in music sales industry-wide. An uncertain economy, a shortened holiday season, a reduction in the overall quantity of music releases and other factors all impacted our sales for the year.

At the same time, there were positive developments. Home video (fueled by strong DVD sales) and video games are demonstrating excellent growth, and Trans World is certainly claiming our share of this growth.

Most of all, however, 2002 was a year of change. The products, sales strategies and distribution methods of retail entertainment are once again in a period of significant transition. After more than 30 years in the retail entertainment business, Trans World is no stranger to change.

In our industry, driven by ever-evolving consumer preferences and emerging technologies, there will always be change. For those with the vision and the resources, there will be opportunities. This is the opportunity for Trans World Entertainment.

From a financial standpoint, 2002 offered its share of challenges.

Total sales for the fiscal year were \$1.3 billion, a decrease of 8% from last year. In particular, I am not pleased with our comparable store sales, down 5% in 2002 – an area in which we will see improvement in 2003.

We were disappointed with our performance in the first three quarters of 2002. However, our fourth quarter, with total sales of \$484 million and a comp sales decrease of 3%, showed improvement compared to other specialty retailers in our industry. While not enough to overcome the disappointing returns of the first three quarters, we believe our fourth quarter delivered a relatively positive conclusion to an otherwise challenging year.

Certainly the industry-wide decline in music sales affected Trans World. Our music sales were down 17% for the year, which had a major impact on our bottom line. In contrast, we achieved excellent growth in DVD and video games – with sales increases of 43% and 37%, respectively.

We continue to maintain a strong financial condition, which allowed us to complete our third five million share stock repurchase program during the year. Furthermore, we funded our LVS implementation through conservative capital spending and the tight control of inventory. Going forward, our positive liquidity gives us the flexibility to execute our business plans and improve our financial results.

Our industry is experiencing substantial transition.

There has been a fundamental shift in our competitive landscape. Specialty entertainment retail has lost market share to “big box” retailers such as Best Buy, Target and Wal-Mart. At the same time, specialty entertainment retail is undergoing consolidation, as evidenced by Best Buy’s closure of over one hundred Musicland stores, and Wherehouse’s and Value Music Concepts’ bankruptcy proceedings. Trans World will take advantage of this consolidation – expanding our market share, solidifying our position as an industry leader.

As we have always done, Trans World made prudent consolidations to our store portfolio in 2002 – closing underperforming stores, both among our mall-based FYE (For Your Entertainment) stores and our freestanding stores. This is simply intelligent business, as we constantly reevaluate and strengthen our national store network.

In terms of the music industry, we anticipate further decline in 2003 (albeit a slower decline than that of 2001 and 2002), but we expect to see positive industry results by the fourth quarter of this year. Trans World is working closely with music industry partners to combat the challenges of piracy – utilizing a variety of methods. We are adding value to music products, incorporating exclusive offers or bonus items. Manufacturers and distributors are striving to increase the quality of product, while developing viable technologies for copy protection – and increasing legal action.

As the music industry works to stabilize, Trans World anticipates further growth in DVD, video games and other product offerings.

Our business is entertainment. We strive to be the choice of entertainment enthusiasts, regardless of the genres, technologies or media of the moment. Our goal is to help people discover entertainment – to find, experience and connect with the products they love. This has long been our mission. That mission continues today.

This is a time of change, and Trans World is ready.

We have reason to look past the challenges of the day. Looking to 2003 and to the future, we have a plan to maintain and extend our tradition of success – and the resources required.

We will leverage our leadership – our fundamental strengths. This includes our unmatched store portfolio, our solid financial position, our customer service and our industry knowledge.

Reversing the negative trend of the past two years, we see opportunities for positive store growth in 2003 – in our mall-based FYE stores and our freestanding store brands Coconuts, Strawberries and Spec's Music.

We are also very optimistic about the launch of our LVS units, the landmark in-store sampling stations rolled out to 550 Trans World stores at the end of last year. Based on an independent consumer usage study, the LVS increases units purchased by 30%. This is a tremendous differentiator for our stores – enhancing the consumer's shopping experience, and maximizing our sales.

We will further build our position as the definitive source for entertainment. We will prepare for the emerging future of digital distribution. While this business will not likely be significant until 2005, it will be developing over the next two years – and Trans World will be a part of it.

As always, we will seek additional strategic advantages – targeting prudent acquisitions and real estate opportunities, while maximizing the profitability of our selling space.

Underscoring everything we do, we will continue our commitment to enhancing shareholder value. We will improve sales and earnings through continued emphasis on growing our DVD and video games businesses, building upon the cross-channel strength of our FYE brand, improving the performance of our music business and maximizing the return on our investment in the LVS.

Through 30 years of industry evolution, Trans World has survived – and thrived. We have no intentions of stopping now. I would like to thank our shareholders, Board of Directors and everyone on the Trans World team for your continued hard work and dedication. Together, we will face change, navigate challenge and look forward to new opportunities.

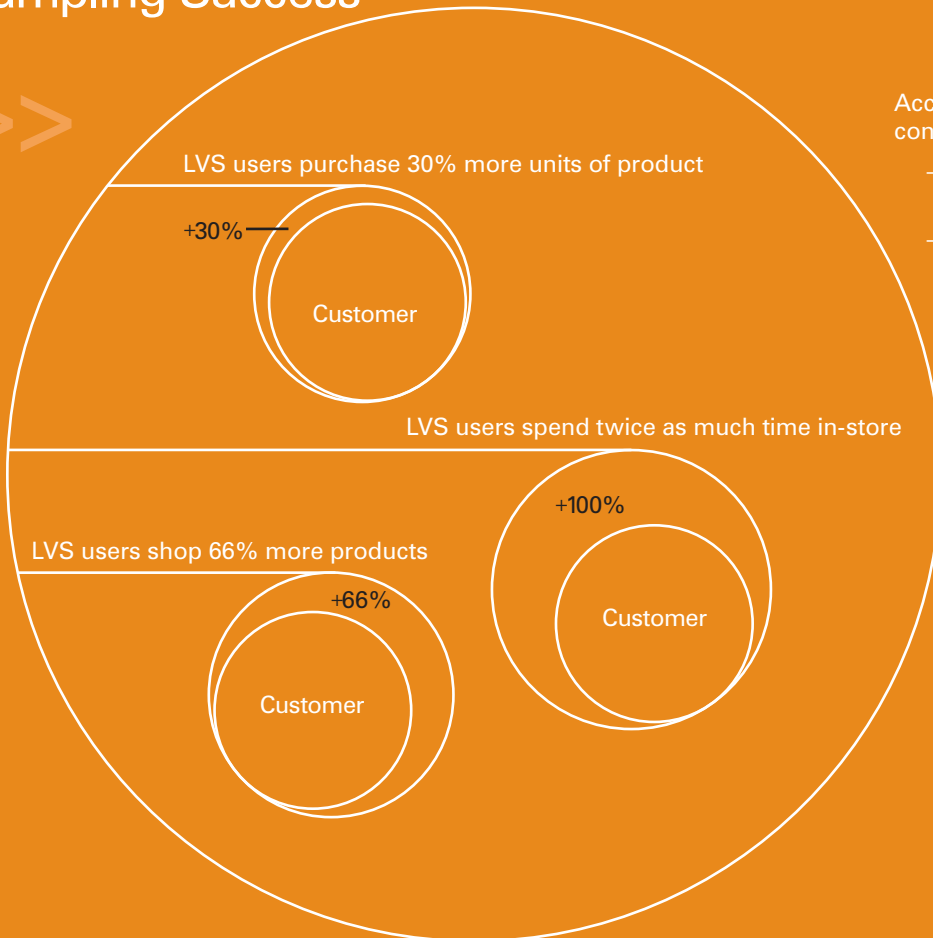


The LVS Advantage

In 2002, Trans World installed 12,000 LVS units in 550 stores across the country. Using advanced proprietary technology, and leveraging our broadband data network, the LVS enables Trans World shoppers to sample nearly every CD, DVD and video game in the store. This investment is already delivering powerful results – giving us a proven tool to maximize and multiply the value of each consumer, while offering customers a unique reason to shop our stores, again and again.



Sampling Success



According to an independent study of consumer usage of the LVS...

- 50% of Trans World customers use the LVS
- This translates to 10 million LVS users each month



Real Estate Strength

The ability to identify, lock in and leverage strategic real estate locations has long been a hallmark of Trans World. In 2002, we further strengthened the industry's leading mall-based portfolio. We did this through growth, by adding new, high-opportunity locations. We achieved this through consolidation and closing underperforming units. We are accomplishing this through increased efficiency, maximizing the profitability of every store...and every square foot.

Mall Stores

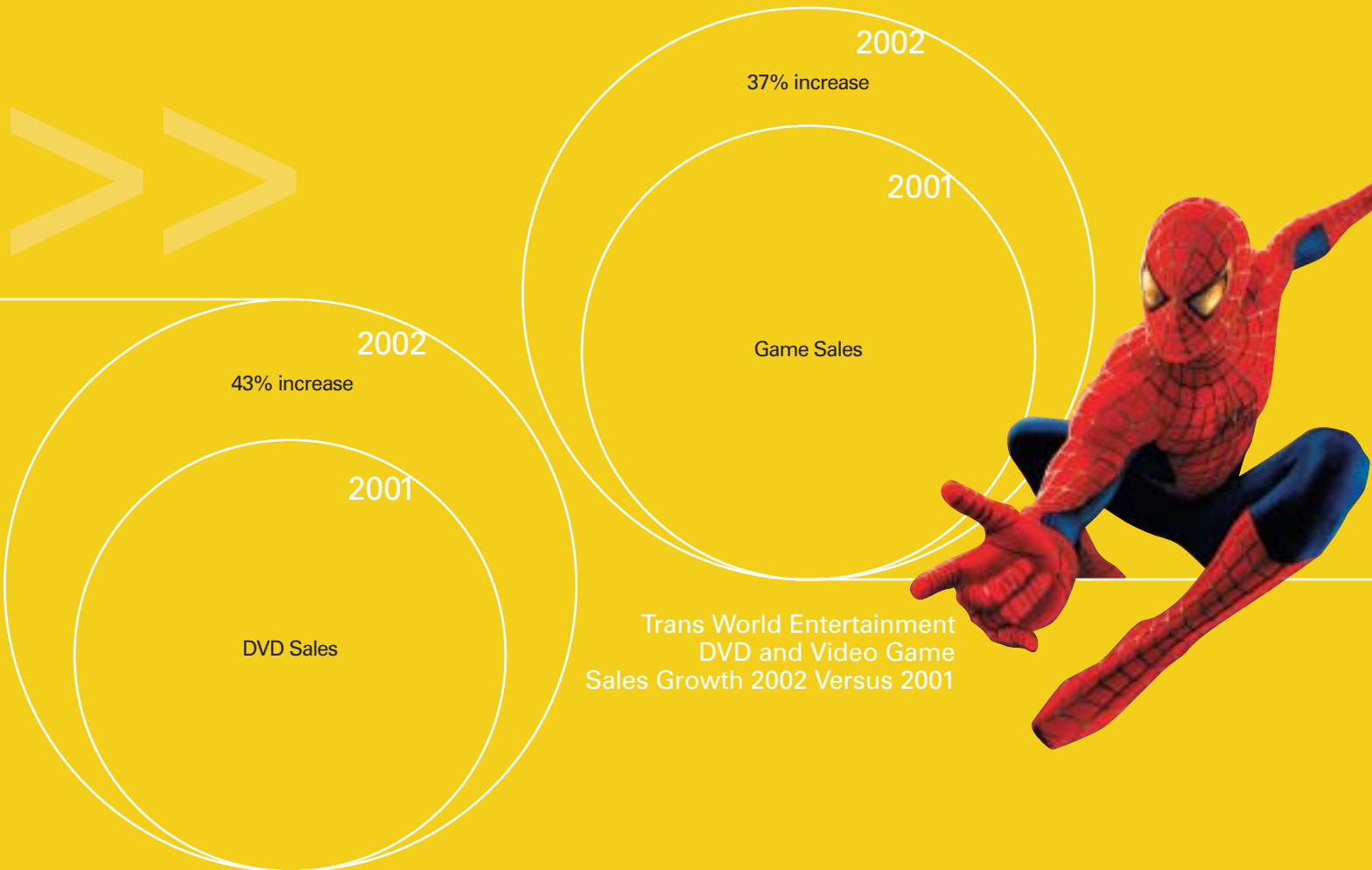
Freestanding Stores





Expanding Entertainment

Trans World continues to diversify its product mix – driving significant growth in DVD and video games. We are a total entertainment store, not solely reliant on the success of a specific product format. No matter the media, regardless of artist or genre, we are the choice of entertainment enthusiasts.



FYE to the Future

In FYE, we have built a national brand of more than 600 stores – reaching millions of consumers each month in the busiest malls across the country – and a content-rich Web expression of that brand at fye.com.

Far more than exposure, we are building customer relationships, delivering a unique experience and inspiring consumers of all ages to explore entertainment as never before. Through customer service and exclusive shopping features like the LVS, we are fostering loyalty – gaining greater market share.

We do not simply sell entertainment; we help our customers discover it. With FYE, we are forming a real connection between us, our customers and the products they love – because we understand and enjoy entertainment as much as they do.

This is yet another extension of the Trans World tradition... one that continues, and grows, today.

We are building on success.

We are leveraging our strengths.

We look forward to the future.

