



Trans World Entertainment

Annual Report 2005

evolving opportunities

OUR INDUSTRY IS IN MOTION. AGAIN.

From the technologies to the products to the competition, specialty entertainment retail is changing and growing in new and exciting ways, while facing new challenges.

Even in what was a disappointing year for our industry, there were successes to be found – opportunities to be seized.



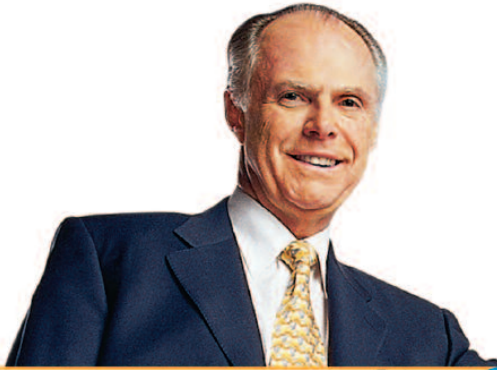


TRANS WORLD ENTERTAINMENT IS IN MOTION. **AGAIN.**

We continue to enhance the customer shopping experience and product mix, to refine and grow our unmatched store portfolio, and to strategically leverage our position as an industry leader.

With a difficult 2005 behind us, we remain focused on the future. Financially stable and strategically positioned. Ready to take advantage of evolving opportunities.

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Once again, due to our financial strength and industry expertise, we have been able to weather industry downturns and disappointments, remaining both opportunistic and optimistic.

Across several business segments, 2005 was a disappointing year for Trans World Entertainment.

Sales for the year, including the critical fourth quarter, were affected by a general weakness in our industry. For a variety of reasons, reflecting in particular the sluggish performance of music sales, we fell short of our sales and profit goals.

In the midst of this disappointment, however, we identified and capitalized on opportunities – including our recent acquisition of the assets of Musicland Holding Corp., our largest specialty entertainment competitor, in the first quarter of 2006.

Due to our financial strength and industry expertise, we have once again been able to weather industry downturns and disappointments, remaining both opportunistic and optimistic.

Our strategic plan – to be a total entertainment retailer, to provide a unique shopping environment, to better connect with our customers, to leverage our in-store technology to grow online and digital product sales, to be an industry consolidator seeking prudent acquisitions – remains sound.

As a leader in our industry, we will continue to seek – and create – new and evolving opportunities.

2005 FINANCIALS

This was a challenging year for specialty entertainment as a whole – and for Trans World.

Our 2005 comparable store sales were down 6% from 2004, while our total store sales decreased 9% to \$1.24 billion. Due to a holiday selling season that was challenging, our fourth quarter results were disappointing, as comparable store sales decreased 8% versus the fourth quarter of 2004.

Though lower than our estimates, we achieved growth in DVD and video games. A particular bright spot was our sales growth in electronics, accessories and boutique businesses – which saw impressive results with the introduction of new products and enhanced merchandising initiatives.

The music industry as a whole was plagued by weak new releases and the continued challenge of digital downloads. This was reflected in our music sales which were down for the year.

In spite of these challenges, our balance sheet remains solid. In December, we completed our 10 million share buyback – reflecting our confidence in the Company, and using our strong financial condition to deliver additional value to our shareholders.

INDUSTRY GROWTH AND CHALLENGES

The growth of sell-through DVD continued in 2005, as industry sales rose 4.5% and totaled \$15.7 billion. While this growth is slowing compared to the explosive expansion of previous years, with a stronger new release

schedule and the anticipated migration to new formats compatible with high definition television, we expect to capture our share of this continued momentum.

The video game industry also continued to grow in 2005, with sales rising 6% for the year. Microsoft's® Xbox 360™ performed well, but a lack of sufficient product negatively affected holiday sales for the category. As we look to 2006, we expect continued growth in video games as new hardware formats are introduced, including PlayStation® 3 in November of 2006 and we have already seen improved supply of product for the Xbox 360™.

After achieving solid improvement in 2004, the music industry disappointed in 2005, as CD sales decreased 8%. This softness in music and growth in other entertainment categories ultimately validates our strategic plan – to diversify our product mix as a total entertainment retailer, reducing our reliance on the success of the newest music releases.

COMPETITIVE ADVANTAGES

As our industry faces further consolidation, there are several key strengths which distinguish Trans World from our competitors.

We are the only specialty retailer that is dedicated to, and delivers on the promise of “all things entertainment” with the only national mall-based chain, selling music, movies and games in one store. We have captured our share of the exciting growth of DVDs and video games. We have leveraged our deep music catalog to distinguish ourselves from the competition. We have created success with sales of

electronics/boutique/specialty items including MP3 players and cell phones. We have defined, and continue to reinvent, specialty entertainment.

We offer an unequaled customer experience. Through our industry-leading LVS (listening-viewing stations) units (enabling customers to instantly preview nearly every title in the store, with future enhancements allowing customers to download music and videos directly onto digital players), and our knowledgeable sales associates, we provide a level of customer service and an environment of "entertainment discovery" unlike any of our competitors. In 2005, we rolled out Backstage Pass, a national customer loyalty program designed to build stronger connections with each consumer – offering discounts, exclusives and other reasons to choose our stores; and combined with Musicland's loyalty program, we have access to over 1 million members.

In an industry where consumers expect – and demand – increased access to all things entertainment, we are delivering. At a time when consolidation is the trend, we have been the consolidator. We are financially sound, and excited for the future.

We are leveraging our best-in-breed in-store technology. Furthering our advantage in this area, Trans World acquired a majority interest in Mix & Burn, LLC, the leading provider of in-store digital content and delivery to retailers nationwide, in early 2006. Mix & Burn will soon expand its offerings to include downloads onto a digital media player and cell phone, offering new sales opportunities.

We have an unmatched store portfolio – now made even stronger with the addition of the Sam Goody chain and 173 Suncoast stores – which are dedicated to movie sales. We will apply our industry expertise to pick and choose the top-performing stores in the Musicland portfolio, and convert them into efficient, profitable Trans World stores.

We have a proven history of identifying highly strategic acquisitions – from Strawberries, Camelot and Spec's to Disc Jockey and Wherehouse – this is what we do, and our most recent acquisition will be our best. We have the real estate savvy and financial resources to capitalize on opportunities that contribute to our business goals.

Our new 5-year, \$130 million revolving credit facility agreement gives us the ability to access funding at reduced rates and positive terms.

At all levels of the Company, we continue to emphasize efficiency, quality and performance. In 2005, we welcomed back Jim Litwak as President and Chief Operating Officer to oversee all merchandising, marketing and store operations for Trans World. Jim had previously served as Executive Vice President, Merchandising and Marketing,

of Trans World from 1996 to 2000, and he joins our seasoned executive team including Bruce Eisenberg and John Sullivan, as well as top talent across our Company.

GOALS: LEVERAGING STRENGTHS, LOOKING FOR OPPORTUNITIES

Our goals for 2006 are focused on leveraging our strengths, and seeking new opportunities.

We will continue to redefine our product offering around critical growth categories, maintaining our emphasis on DVD and video games, and expanding our electronics, boutique and accessory specialty offerings.

We will promote and leverage the next generation of our exclusive LVS system, and provide best-in-class customer service. We will emphasize our innovative in-store services, delivering all things entertainment, at the convenience of our customers.

Through a wide range of marketing, we will continue to strengthen our f.y.e. brand – advancing our position as the preferred retail entertainment destination throughout the United States.

We will continue to assess and refine our national store network, and seek prudent additions that enhance our revenue and market share.

Across everything we do, we will continue to create, sustain and grow value, on behalf of our shareholders.

THE EVOLUTION CONTINUES

It bears reminding: we have been doing this since 1972. We are no stranger to change, we have faced three decades of evolution in specialty entertainment, and we have methodically, strategically, prudently built this Company into an industry leader.

Though we face challenges, our strategic plan is working. In an industry where consumers are constantly looking for increased access to all things entertainment, we are delivering. At a time when consolidation is the trend, we have been the consolidator. We are financially sound, and excited about the future.

I would like to thank our shareholders, board of directors, my executive team and our over 10,000 associates nationwide for their support and dedication. Together, this team will work to find, create and capitalize on new opportunities.



We now have stores in all 50 states, Puerto Rico and the U.S. Virgin Islands



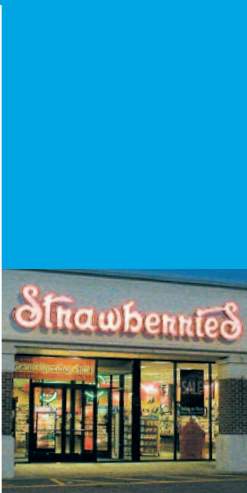
OPPORTUNITY:
CONSOLIDATION

The continuing trend toward industry consolidation offers opportunities for Trans World – to reach new customers, to increase market share and revenue, to grow our already unmatched store portfolio, and to maximize our leverage as an industry leader.

We have a proven history of making strategic acquisitions which immediately contribute to our business goals, and we will seek new opportunities in 2006 and beyond. In the first quarter of 2006, we acquired the assets of Musicland Holding Corp. – our largest specialty entertainment

retail competitor, with store locations and formats that align with and complement our own. With our fundamental financial strength, we are in position to continue this momentum.

Our acquisition of Wherehouse Entertainment was **profitable in its first year of operation.** We know how to identify and seize strategic acquisitions.





We are currently testing the f.y.e. Download Zone, a store-within-a-store concept, where consumers can instantly **burn custom CDs** from a vast digital music library (offering downloads for digital media players and cell phones in the future).

OPPORTUNITY:
CUSTOMER FOCUS

Our unique, customer-driven shopping experience gives us another advantage – and opportunity.

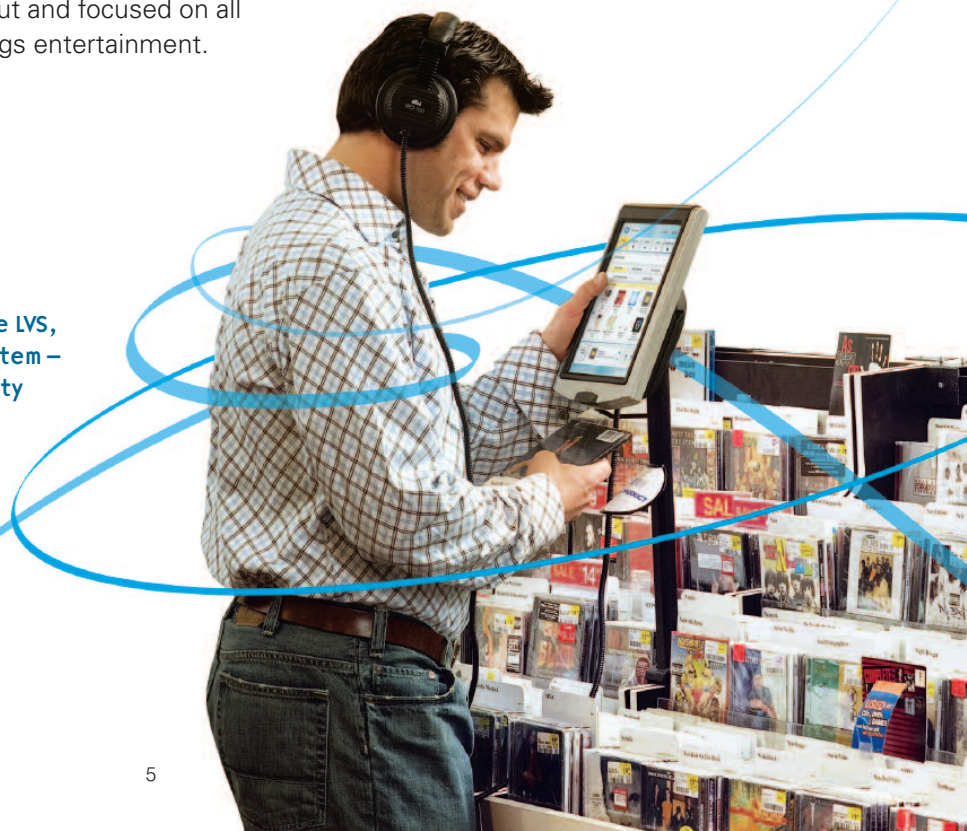
Online and in-store, interactive and integrated, everything we do is built around the needs and preferences of our customers. Unlike our big box and consumer electronics competitors, we provide a deep selection of catalog titles.

We offer a revolutionary in-store product sampling system, the LVS, driving entertainment discovery and incremental sales.

We recently launched Backstage Pass, a customer loyalty program aimed at building greater share-of-wallet per customer.

In addition, our team of sales associates is truly best-in-class, because they are passionate about and focused on all things entertainment.

We continue to refine the LVS, our in-store sampling system – increasing its functionality to give our stores a true competitive advantage.



OPPORTUNITY:

TOTAL ENTERTAINMENT

More than any of our competitors, we are a total entertainment retailer – providing another key point of differentiation.

We offer the depth and breadth of entertainment products that customers are looking for in one store: CDs, DVDs, video games, electronics including MP3 players, magazines, specialty/ boutique items and more. This means two things: customers can find everything entertainment in one convenient location and we are by no means entirely reliant on the success of any

one entertainment category or the performance of the latest top sellers. Wherever the growth is, whether it is sales of newest video game formats or home entertainment platforms, we will capture our share.

In 2005, music sales accounted for slightly more than 50% of our total sales – down from over 75% in 2000. This reflects our continuing **emphasis on product diversification,** and demonstrates our growth in all things entertainment.





**OPPORTUNITY:
EVOLUTION AND GROWTH**

The ever broadening category of “entertainment” offers tremendous opportunity for our industry, and for Trans World.

From advances in home theater to a variety of new ways to enjoy music, movies and games on the go, consumers are investing more than ever in entertainment technologies and products.

The nearly \$16 billion DVD industry continues to grow – offering exciting new potential as high definition (HD) format DVDs are rolled out in 2006 and 2007.

The more than \$10 billion video game industry likewise continues to grow, as game formats, titles and genres expand, appealing to a broader range of ages.

Even though the music industry has seen its challenges of late, the ease and convenience of digital music is enlivening and reawakening interest in all music categories. At only 99 cents a song or via subscriptions (as offered at www.fye.com), more and more consumers are exploring the vast music universe.

All of this growth and change, awareness and excitement, bodes well for Trans World Entertainment. We have the infrastructure in place to meet the current and future needs of our customers... to seize these evolving opportunities.

\$15.7 billion
DVD Industry
Sales 2005



\$352 million
Trans World
DVD Sales 2005

Source: Video Business

\$10.5 billion
Games Industry
Sales 2005



\$90 million
Trans World
Games Sales 2005

Source: NPD Group

\$12.3 billion
Music Industry
Sales 2005



\$664 million
Trans World
Music Sales 2005

Source: RIAA