



T r a n s W o r l d E n t e r t a i n m e n t

A n n u a l R e p o r t 2 0 0 6

Letter from the Chairman/CEO



While generating record sales of \$1.5 billion, our transition to a total entertainment retailer remains challenging.

For 2006, our total sales increased 19% to just under \$1.5 billion – an all-time high for our 35-year-old company. This was primarily due to an increase in average store count associated with our 2006 Musicland acquisition.

Despite our overall sales increase, our 2006 net income of \$11.7 million, which included an extraordinary gain related to our acquisition of Musicland, was still below our expectations.

Comparable store sales for 2006 were disappointing – down 6% from 2005. This was due to a 14% decrease in comp store sales of music. Even though we claimed greater market share of total U.S. music sales versus the previous year, this was not up to our expectations.

Comp sales in DVD increased 6% for the year, as this category remains positive for us. In a relatively flat industry, we grew our market share of total U.S. DVD sales significantly, helped by the acquisition of Musicland and its Suncoast video chain.

The key, once again, is minimizing the impact of the industry-wide decline in music sales, increasing our market share and maximizing the growth in our other product lines – while improving customer loyalty and satisfaction.

Comp sales in video games increased 4% in 2006, and we achieved 8% growth in other categories including electronics, accessories and boutique – demonstrating the strength and potential of these growing product lines.

The holiday selling season has always been critical to our success. Although our fourth quarter performance did not meet our expectations, total sales for the quarter were \$587 million, a 28% increase from last year. As with our total 2006 sales, this was largely due to the Musicland acquisition – we operated an average of just under 1,100 stores during the quarter compared to approximately 800 stores in the fourth quarter of 2005. We delivered \$67 million in EBITDA (a 50% improvement over 2005 and our highest total since 2001), income before extraordinary gain of \$32 million (a 45% improvement over 2005) and \$1.00 earnings per share (our best fourth quarter results since 1999).

We are reshaping our product mix to maximize our opportunities.

Consider this: music sales represented 44% of our business in 2006. This was down from 54% in 2005 and over 75% in 2001.

Video sales for 2006 comprised 38% of our business, up from 30% in 2005 and 19% in 2001. Video games represented 8% of our business this year versus 7% in 2005; and electronics, accessories and boutique represented 10% of sales, up from 9% in 2005.

As part of our continuing evolution as a total entertainment retailer, we are expanding our selection of in-demand products, leveraging our strategic store locations, maximizing every foot of selling space and proactively seeking ways to create value for and build long-term relationships with our customers.

In 2006, we increased the floor space dedicated to DVD, piloted new ways to merchandise video games, offered more exclusive CD and DVD compilations and expanded our marketing efforts including increased broadcast advertising and sponsorship activities... all while maximizing the proven cross-sell ability of our in-store sampling system, the LVS. We also continued to increase our online business, and we expect further improvement in 2007 based on enhancements made to our Web site, fye.com, in February.

As we look ahead to 2007, we are optimistic and energized.

We are cautious in regard to sales projections, but we are optimistic in our ability to improve our bottom line.

We are managing our business in 2007 to a mid-single digit comp sales decrease and a total sales decline of approximately 10%, due to a lower average store count (at the end of 2006, we closed a significant number of stores that were negatively impacting our bottom line). We believe our focus on gross margin improvement and expense reductions will result in positive earnings for the year.

The key, once again, is minimizing the impact of the industry-wide decline in music sales, increasing our market share in music sales and maximizing the growth in our other product lines – while improving customer loyalty and satisfaction.

In terms of the DVD category, we will emphasize new releases and catalog titles to continue to drive the business – while promoting sales of new DVD formats such as Blu-ray and HD as they become a larger percentage of overall DVD sales.

In video games, we will capture our share of growth in the PlayStation®3, the Wii and Xbox 360™ platforms, while expanding the handheld and accessory categories.

We will continue to dedicate increased floor space to electronics, accessories and trend/boutique products, which will help to improve our average ticket with an exciting lineup of entertainment-related products.

Our flagship brand continues to grow with the rebranding of our freestanding stores to F.Y.E. (For Your Entertainment). We currently have 680 F.Y.E. stores nationwide, and the majority of the remaining stores will be converted by the end of the second quarter in 2007. From coast to coast, in high-traffic malls and open air centers everywhere, shoppers will find an interactive, customer-centric shopping experience wherever they see the F.Y.E. brand.

Leveraging the strength of our brand, we will expand marketing efforts, particularly in markets with a large number of newly-rebranded F.Y.E. stores. We will broaden the reach of Backstage Pass, our customer loyalty program, by increasing membership and targeting these core customers – via email and at the point of sale, with highly-customized messaging through our in-store LVS system.

We are very excited about the 40-store pilot program of in-store CD-burning and digital downloading stations, including over a dozen stores in the Providence, Rhode Island area. This will offer our customers easy, instant ways to purchase digital files and customized CDs (without digital rights management restrictions), as we strive to increase market share in the nearly \$2 billion digital download business. In addition to convenience, we will offer additional value – such as bonus tracks, exclusive content and complimentary downloads – to fully leverage the synergies between physical and digital formats, and give customers another reason to shop our stores.

Concluding an initiative begun in 2006, all of our associates will soon have completed extensive training to better support our

customers. We will continue to measure our performance in this area – because friendly, knowledgeable associates, who know and love entertainment, are a clear point of differentiation for our store experience.

We are confident that these strategies, along with our efforts to shed unprofitable stores and lower our expenses, will improve our results.

\$1.5 billion in sales says three things: the customers are there; we are a much broader entertainment retailer than we have ever been; we have tremendous opportunity to drive bottom-line performance.

2006 was a challenging year for Trans World, but we are making progress in executing our strategic plan to become a total entertainment destination.

I would like to thank our many partners – shareholders, employees, vendors and other strategic partners – for your support.

Trans World remains committed to serving the ever-evolving entertainment needs of our customers... to making F.Y.E. the preferred entertainment destination... and to increasing returns for you, our valued shareholders.



Key '07 Initiatives

▶ Rebranding Complete

By the second quarter of 2007, all of our freestanding stores will be rebranded as F.Y.E. – leveraging our national brand presence and creating a consistent shopping experience for our customers.

▶ Personalized Pass

We are enhancing our Backstage Pass loyalty program, including utilizing our LVS system to offer personalized suggestions and promotions for our best customers... at the point of sale.



▶ Digital Delivered

In 2007, we are piloting custom CD-burning and digital downloading stations in 40 of our stores – providing a convenient new service for our customers as well as exclusive tracks and content (available only at F.Y.E.).



▶ Sales Oriented

We recently completed a national associate training program – ensuring that all of our employees are living the F.Y.E. brand.



Financial Highlights

(in thousands except per share and store data)

	2006	2005	2004	2003	2002
Sales ▶	\$1,471,157	\$1,238,486	\$1,365,133	\$1,330,626	\$1,281,869
Change in total sales ▶	18.8%	(9.3)%	2.6%	3.8%	(7.6)%
Change in comparable store sales ▶	(6.2)%	(5.7)%	0.8%	1.3%	(5.0)%
Net income (loss) ▶	\$11,669	\$609	\$41,841	\$23,067	\$(45,470)
Diluted earnings (loss) per share ▶	\$0.36	\$0.02	\$1.15	\$0.60	\$(1.13)
Total assets ▶	\$829,690	\$799,657	\$859,563	\$817,758	\$803,396
Shareholders' equity ▶	\$393,205	\$378,512	\$404,323	\$399,184	\$392,104
Total stores ▶	992	782	810	881	855



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Corporate Office

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Independent Auditors

KPMG LLP, Albany, NY

Transfer Agent and Registrar

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Toll-free: 1-800-288-9541
TTD: 1-800-231-5469

Stock Exchange Listing

NASDAQ National Market
Trading Symbol – TWMC

Annual Meeting

June 6, 2007, 10:00 a.m., The Desmond, Albany, NY



for your entertainment
music • movies • games • more

SUNCOAST™
The store for movie lovers.

A copy of the Company's Annual Report on Form 10-K for the fiscal year ended February 3, 2007 and quarterly reports on Form 10-Q may be obtained by shareholders without charge from the following:

Chief Financial Officer
Trans World Entertainment Corporation
38 Corporate Circle, Albany, NY 12203

*Member of the Audit Committee

†Member of the Compensation Committee

‡Member of the Nominating and Governance Committee

°Presiding Director

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