



**More To Come.**

**Trans World Entertainment**

**1999 Annual Report**

Trans World Entertainment Corporation is one of the largest entertainment retailers in the United States. Founded in 1972, the Company currently operates 967 stores in 44 states, the District of Columbia, Puerto Rico and the U.S. Virgin Islands, and operates a retail Web site at [www.twec.com](http://www.twec.com). Its stores are divided into two divisions: mall and freestanding. Mall stores include Camelot Music, Record Town, The Wall, F.Y.E. (For Your Entertainment) and Saturday Matinee. Freestanding stores include Coconuts Music & Movies, Strawberries, Spec's and Planet Music.

The Company offers a wide selection of entertainment products, including compact discs, prerecorded audio and videocassettes, digital versatile discs (DVDs), video games and personal electronics. In addition, Trans World Entertainment provides digitally-distributed music, custom compilations and exclusive live artist events through its e-commerce Web site, [twec.com](http://twec.com).

The Company's headquarters are located in Albany, NY; it maintains distribution facilities in North Canton, OH and Albany, NY.

Trans World Entertainment, which established itself as a public company in 1986, is traded on the NASDAQ National Market under the symbol "TWMC."

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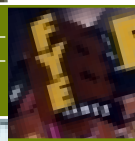
In 1999, Trans World Entertainment

achieved record-setting sales and

profits – for the third year in a row.

More  
More  
More  
More  
More  
More

Than Ever.



## Our Best Year Ever! (Again)

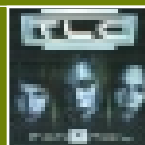
\$1.4 billion in sales

16 consecutive quarters  
of comp sales growth



More

More



More

More

To Come.

# It was the year of More.



Across all four quarters, we reported positive comparable store sales – extending our streak to 16 quarters in a row.

More sales. More profits. More growth – across our entire retail infrastructure.

In 1999, 27 years after the Company's inception, Trans World Entertainment is unquestionably the strongest retailer in one of the most dynamic, rapidly-expanding industries in the world.

No doubt about it: the retail entertainment business has been forever transformed. New technologies are changing the way consumers shop for and purchase entertainment media. The Internet is profoundly altering the relationship between retailers and customers – and opening the floodgates to new products and new distribution methods. Most importantly, this is a revolution that has only just begun.

## **For Trans World, This Is Good News.**

We have proven that our fundamental principles of intelligent management, informed decision-making and strategic vision remain the keys to success in our industry. We are in an excellent position – from our sterling balance sheet to our solid infrastructure – to reap even greater returns.

As we look back on this year of “More,” we now look forward to more potential than ever.

## **Another Command Performance**

From a financial standpoint, 1999 was a great year. In fact, another great year. Trans World improved upon consecutive record-setting performances in 1997 and 1998.

In 1999, sales totaled \$1.4 billion, compared to \$1.3 billion in 1998. It was a highly profitable year as well. Earnings topped \$77 million (before a one-time Camelot merger charge), versus \$61 million the previous year. This was all driven by a best-ever

fourth quarter, in which we achieved \$518 million in sales and \$61 million in earnings. Across all four quarters, we reported positive comparable store sales – extending our streak to 16 quarters in a row.

While ringing up record numbers, we also implemented key efficiencies. We reduced our Selling, General and Administrative (SG&A) expenses as a percentage of sales by 1.7% – further contributing to our bottom line.

## **Camelot Integrated**

Certainly the above numbers speak directly to the successful addition of nearly 500 Camelot stores into the Trans World portfolio. Acquired in April of 1999, these stores helped to extend Trans World's reach into important new markets and helped to solidify our geographic dominance nationwide. Our investment has already begun to pay off.

## **e-Commerce Surge**

Established in November 1998, Trans World's e-commerce site at

www.twec.com took major strides toward becoming one of the nation's leading retail entertainment sites in 1999. Sales and site traffic continued to increase significantly each month and we recorded 2.4 million unique visitors in the fourth quarter. These increases can be attributed to hundreds of online artist events, exclusive content, on-demand media and other innovative marketing initiatives – as we continue to build awareness, and business, in the all-important e-commerce arena.

### **New Leadership**

One of the industry's most experienced, most successful executive management teams was further strengthened in 1999 – as Michael J. Madden joined Trans World as President and Chief Operating Officer. Michael brings more than 30 years of retail management experience to our Company, including serving as President of the toy division of Toys "R" Us. He will help us take Trans World to the next level.

### **F.Y.E. Expansion**

Trans World continued to grow our flagship superstore concept F.Y.E. (For Your Entertainment). We added five new F.Y.E. stores in 1999 – bringing our total superstore count to twelve. This store concept is a proven winner in locations across the country. We expect similarly strong results from the latest additions to this concept.

### **Strategic Alliances**

Leveraging our position as an industry leader, Trans World forged numerous strategic alliances last year. Among them, we expanded our relationship with RealNetworks, Inc. – forming a technology/marketing alliance between twec.com and RealJukebox digital music software. We also became the preferred retail link from gigmania.com, a leading site for live music information

nationwide. These alliances allow Trans World to access a broader mix of consumers – making us their definitive source for entertainment media.

### **In Position**

As you can see, 1999 was an important year – and a highly successful one – on many fronts. Perhaps most importantly, however, 1999 was a year in which Trans World made vital preparations for the year and years to come. As our Company readies to enter a new phase of operations, as a fully-integrated retail network, we have all the necessary ingredients to do it intelligently and successfully. More than a tightly-run, stable, highly-profitable company, Trans World is founded upon solid, innovative thinking from experienced management. This is the thinking that will propel us forward and guide us through the critical, and exciting, times to come.

### **2000 Goals**

Trans World will be working toward several major initiatives in 2000 and beyond, representing the most significant period of change in the history of our Company.

Our primary big-picture goal will be the unification and integration of the entire Trans World retail brand – in stores, on the Web, via communications and networking – bringing our "clicks and bricks" strategy to fruition. Concurrently, we will continue to build and enhance our Web presence and e-commerce marketshare. We will leverage the strength of our retail infrastructure by driving customers from our stores to our Internet site, and vice versa – achieving new levels of synergy.

We will meet our goal of repurchasing five million shares of common stock – reinvesting in a stock that is clearly undervalued. Initially implemented in

January 2000, this program will have been completed by the end of the first quarter.

While working toward larger goals, Trans World will remain focused on the details. We will maximize sales and profits across all of our retail channels. We will look for any and all opportunities for prudent growth. We will continue to lead the industry with breakthrough marketing initiatives and customer relationship-building programs. We will stay committed to efficiency and profitability, and increasing shareholder value. These have been, and will continue to be, the heart of Trans World's success.

### **More To Come**

Our biggest year ever. Even bigger plans ahead.

I would like to thank everyone who contributed to our recent successes and to our excellent 1999 performance. Shareholders, employees, suppliers and developers – you have all worked to make these achievements possible. I will be relying on your continued support to help Trans World advance and evolve.

Clearly, there is untold potential for growth in our evolving industry. As we have been in the past, and as we are today...Trans World will continue to lead.



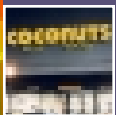
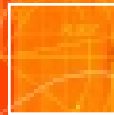
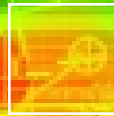
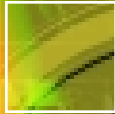
Robert J. Higgins  
Chairman/Chief Executive Officer  
Trans World Entertainment

More

More

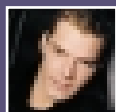
More

# More Than Ever.



## Here we are.

At the start of a new millennium...in the midst of an industry revolution...capping off a third consecutive year of record sales and profits...Trans World Entertainment is hungry for more.



# More To Come.

More

More

## Opportunities abound.

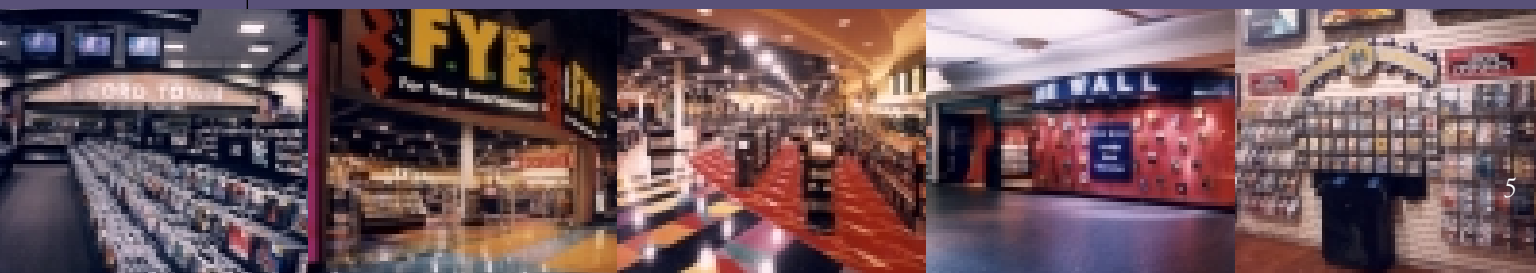
The Internet, digital downloads and other technologies have forever altered the retail entertainment landscape. Consumers are demanding more flexibility, more convenience, more products – more of everything – than ever before. New competitors, of every variety, are sprouting up to answer this demand. By all estimates, there will be significant growth throughout the industry.

## Trans World is in a perfect position.

We know this business like no one else does – with a proven 27-year history of success and innovation. We have the financial strength and strategic ability to seize emerging opportunities. We have the industry’s strongest, most profitable infrastructure, from 967 stores nationwide to a rapidly-growing e-commerce site.

More

# We are ready for what’s next.



## Trans World is everywhere.

Following the acquisition of Camelot Music Holdings, Inc., we integrated to 967. These are not just stores, however. These are Trans World stores: and profitability. In 2000, we will continue to maximize the full potential

With proper leveraging, Trans World's combination of "Clicks & Bricks"

close to 500 stores into our store portfolio in 1999 – to bring our nationwide total known for efficiency, deep catalog selection, a unique focus on customer satisfaction of every store, and to look for intelligent opportunities for growth.

Clicks  
Clicks  
Clicks

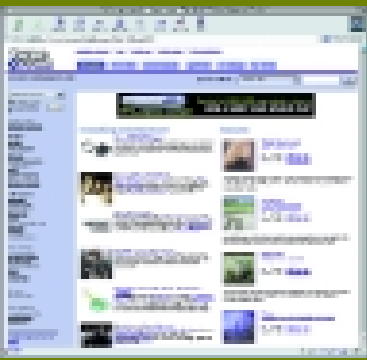
# Clicks & Bricks

## We go way beyond stores now.

1999 saw our e-commerce site at [www.twec.com](http://www.twec.com) come into its own. Launched in 1998, the site achieved a significant increase in traffic and sales last year. We expect this upward climb to continue in 2000 as word spreads about our highly-shoppable, title-packed, content-driven site.



Bricks  
Bricks  
Bricks



## Synergy plus leverage equals power.

In 2000 and beyond, we will be exploring breakthrough ways to achieve synergy throughout our retail infrastructure. Our stores driving traffic to our site... our site driving traffic to our stores...strategic marketing alliances with leading entertainment sites, content providers and technology companies...all working together to boost sales and foster customer relationships.

– integrated stores and Web – may well define the industry standard.



Innovation

Innovation

Innovation

# Innovation on Demand

## They come to us for exclusive entertainment.

In stores across the country, and weekly on our Web site, Trans World delivered hundreds of live appearances from the industry's top artists in 1999. We hosted concerts and in-store autograph signings. On the Web, we offered over 240 exclusive performances and live chat events last year.

## They come to us for exclusive products.

In the fourth quarter of 1999, we launched a full line of more than a dozen custom CD compilations from a wide range of musical genres. These are products that perform well, that are highly profitable – that you can only purchase at Trans World retail stores.

## They come to us for what's new.

New releases, a perennial driver of sales in this industry, have become a particular focus for Trans World. We are now partnering with suppliers in a range of aggressive marketing and merchandising efforts to claim a larger piece of this pie. When a customer's favorite new CD, DVD, video or video game comes out – that customer will come to us.



Demand

Demand

Demand

In 2000 and  
beyond, watch  
for even more  
innovation.

**making it happen.**

constantly devising innovative ways to stand apart. From consumers a compelling reason to choose us – again and again.



## **We are not simply growing for growth's sake.**

Each of our strategic acquisitions, affiliations and initiatives is a carefully-calculated move. While the retail entertainment industry is in growth mode, it is also in consolidation mode. There will be further consolidation in the years to come. Because of our financial strength and industry position, Trans World will be seizing new opportunities – increasing our marketshare through sustaining prudent, profitable growth.

# Sustainable Growth

Sustainable Growth

Sustainable Growth

Sustainable Growth

## **We are achieving growth by creating value.**

For our customers, value means understanding their needs – and meeting them – better than anyone else. It means reaching targeted consumer segments with the most relevant messages in the most appropriate media. It means delivering the products they want, the way they want them. The desire for entertainment, regardless of format or shopping environment, is a basic human need; we know how to answer it.

## **We are enhancing value at our very core.**

Well-known and well-respected, Trans World has emerged as the industry employer of choice. We are constantly working to recruit the best and brightest, people who will bring energy and vision to the Company. We place special emphasis on retention and internal communications – to keep this talent on our team.



**These are investments in our Company and our future – from which we expect excellent results.**

What's Next

What's Next

What's Next

## What's Next

### **It's happening right now.**

The future growth of Trans World is very much in motion. Major branding initiatives are underway. Cutting-edge technologies are being incorporated into our e-commerce efforts. New alliances are being explored. New opportunities are being sought after and seized.

### **By 2001, you will see the next generation Trans World.**

Fully-integrated across our retail infrastructure, Trans World will be leveraging our many strengths to achieve new levels of operating efficiency, consumer awareness and performance. We will also be more closely integrated with our suppliers and customers – taking full advantage of these relationships.

### **Some things, however, will not change.**

We have grown to our current position because of one simple truth: we know how to be successful in this business. With a constant eye on our bottom line and an unflagging commitment to maximizing shareholder value, Trans World will undergo this evolution intelligently and strategically...and successfully.

**Exciting times are ahead, and we are there.**

## Financial Highlights

	1999	1998	1997	1996	1995
<i>(in thousands, except per share and store data)</i>					
Sales	\$1,358,132	\$1,282,385	\$571,314	\$481,657	\$517,046
Change in total sales	5.9%	124.5%	18.6%	(6.8)%	(3.7)%
Change in comparable store sales	2.0%	7.5%	10.2%	3.6%	(3.5)%
Net income (loss)	\$ 61,393	\$ 61,010	\$ 20,574	\$ 7,102	(\$23,816)
Diluted earnings (loss) per share	\$ 1.15	\$ 1.14	\$ 0.66	\$ 0.24	(\$0.82)
Total assets	956,410	798,610	374,019	311,610	391,888
Shareholders' equity	494,173	432,376	124,522	102,919	95,661
Total stores	967	988	539	479	542

Financial Highlights

## Selected Consolidated Financial Data

The following table sets forth selected consolidated financial data and other operating information of the Company and gives retroactive effect to the acquisition of Camelot Music Holdings, Inc. (“Camelot”) for the periods subsequent to its “fresh-start reporting” on January 31, 1998, upon its reemergence from bankruptcy. The acquisition was accounted for using the pooling-of-interests method of accounting. The selected income statement and balance sheet data set forth below are derived from the audited consolidated financial statements of the Company for the five fiscal years ended January 29, 2000. Each fiscal year of the Company consisted of 52 weeks except the fiscal year ended February 3, 1996, which consisted of 53 weeks. All share and per share amounts have been adjusted for stock splits. The information is only a summary and should be read in conjunction with the Company’s audited consolidated financial statements and related notes and other financial information included herein and “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

INCOME STATEMENT DATA:	Fiscal Year Ended				
	January 29, 2000	January 30, 1999	January 31, 1998	February 1, 1997	February 3, 1996
	<i>(in thousands, except per share and store data)</i>				
Sales	\$1,358,132	\$1,282,385	\$571,314	\$481,657	\$517,046
Cost of sales	858,588	796,311	361,422	308,952	347,554
Gross profit	499,544	486,074	209,892	172,705	169,492
Selling, general and administrative expenses	371,998	372,886	170,834	150,218	168,313
Camelot merger-related costs <sup>(1)</sup>	25,473	—	—	—	—
Asset impairment charge and restructuring charge (reversal), net <sup>(2)</sup>	—	1,537	—	—	24,204
Income (loss) from operations	102,073	111,651	39,058	22,487	(23,025)
Interest expense	3,496	4,989	5,148	12,110	15,201
Other expenses (income), net	(4,086)	(2,221)	(153)	(1,343)	(979)
Income (loss) before income taxes	102,663	108,883	34,063	11,720	(37,247)
Income tax expense (benefit)	41,270	47,873	13,489	4,618	(13,431)
Net income (loss)	\$ 61,393	\$ 61,010	\$ 20,574	\$ 7,102	(\$23,816)
Basic earnings (loss) per share	\$ 1.17	\$ 1.19	\$ 0.70	\$ 0.24	(\$0.82)
Weighted average number of shares outstanding – basic	52,457	51,105	29,483	29,271	29,178
Diluted earnings (loss) per share	\$ 1.15	\$ 1.14	\$ 0.66	\$ 0.24	(\$0.82)
Weighted average number of shares outstanding – diluted	53,354	53,530	31,032	29,697	29,178
<b>BALANCE SHEET DATA: (at the end of the period)</b>					
Working capital	\$ 303,562	\$ 274,535	\$ 88,974	\$ 80,368	\$ 78,773
Total assets	956,410	798,610	374,019	311,610	391,888
Current portion of long-term obligations	5,311	4,802	99	9,557	3,420
Long-term obligations	19,461	36,065	41,409	50,490	60,364
Shareholders’ equity	494,173	432,376	124,522	102,919	95,661
<b>OPERATING DATA:</b>					
Store Count (open at end of period):					
Mall stores	723	741	340	357	379
Freestanding stores	244	247	199	122	163
Total stores	967	988	539	479	542
Comparable store sales increase (decrease) <sup>(3)</sup>	2.0%	7.5%	10.2%	3.6%	(3.5)%
Total square footage (in thousands)	4,913	4,693	2,442	2,008	2,140

(1)The Camelot merger-related costs included the write-off of the book value of retired assets, professional fees associated with the completion of the merger, severance costs, joint proxy printing and distribution costs and regulatory filing fees.

(2)The asset impairment charge and restructuring charge (reversal), net, during the year ended January 30, 1999, included an asset impairment charge of \$3.7 million to write down the carrying amount of certain fixed assets at stores, primarily leasehold improvements and the one-time reversal of the remaining balance of \$2.2 million in the store closing reserve originally established during the fiscal year ended February 3, 1996. See Notes 1 and 2 to the Consolidated Financial Statements. During the year ended February 3, 1996, it included the write-down of assets, estimated cash payments to landlords for the early termination of operating leases, early termination benefits and estimated professional fees. Inventory-related costs, including the cost of returning merchandise after the store closes, are included in cost of sales.

(3)A store is included in comparable store sales calculations at the beginning of its 13th full month of operation.

## Management's Discussion and Analysis

of Financial Condition and Results of Operations

The following is an analysis of the Company's results of operations, liquidity and capital resources. To the extent that such analysis contains statements which are not of a historical nature, such statements are forward-looking statements, which involve risks and uncertainties. These risks include, but are not limited to, changes in the competitive environment for the Company's merchandise, including the entry or exit of non-traditional retailers of the Company's merchandise to or from its markets, the release by the music industry of an increased or decreased number of "hit releases," general economic factors in markets where the Company's merchandise is sold and other factors discussed in the Company's filings with the Securities and Exchange Commission.

### RESULTS OF OPERATIONS

The following table sets forth, for the periods indicated, certain income and expense items as a percentage of sales:

	January 29, 2000	Fiscal Year Ended January 30, 1999	January 31, 1998
Sales	100.0%	100.0%	100.0%
Gross profit	36.8%	37.9%	36.7%
Selling, general and administrative expenses	27.4%	29.1%	29.9%
Camelot merger-related costs	1.9%	—	—
Restructuring charge reversal and impairment charge, net	—	0.1%	—
Income from operations	7.5%	8.7%	6.8%
Interest expense	0.3%	0.4%	0.8%
Other expenses (income), net	(0.3)%	(0.2)%	0.0%
Income before income taxes	7.5%	8.5%	6.0%
Income tax expense	3.0%	3.7%	2.4%
Net income	4.5%	4.8%	3.6%
Change in comparable store sales	2.0%	7.5%	10.2%

#### Fiscal Year Ended January 29, 2000 ("1999") Compared to Fiscal Year Ended January 30, 1999 ("1998")

**Sales.** The Company's sales increased \$75.7 million, or 5.9%, from 1998. The increase was primarily attributable to a comparable store sales increase of 2.0%, and the addition of approximately 220,000 square feet of retail selling space through the opening of 34 stores and relocation of 46 stores, which was partially offset by the closing of 55 stores. Management attributes the comparable store sales increase to its focus on customer service, superior retail locations, inventory and merchandise presentation.

For 1999, comparable store sales increased 1.6% for mall stores and 4.2% for freestanding stores. By merchandise category, comparable store sales increased 1.1% in music, 9.9% in video and decreased 4.5% in other merchandise.

**Gross Profit.** Gross profit, as a percentage of sales, decreased to 36.8% in 1999 from 37.9% in 1998, primarily as a result of higher inventory shrinkage in the acquired Camelot stores. The Company has taken action to reduce shrink at the Camelot stores, including implementing policies and procedures that have successfully kept shrink at reduced levels for the Company in the past.

**Selling, General and Administrative Expenses.** SG&A, as a percentage of sales, decreased to 27.4% in 1999 from 29.1% in 1998. The 1.7% decrease can be attributed to the leverage of SG&A on the total sales increase and the reduction of corporate overhead expenses through the consolidation of the Camelot corporate offices.

**Camelot Merger-Related Costs.** The Camelot merger costs, net, represents the one-time charge of \$25.5 million for costs directly related to completing the merger with Camelot Music Holdings, Inc. The costs included the write-off of the book value of retired assets, professional fees associated with the completion of the merger, severance costs, joint proxy printing and distribution costs and regulatory filing fees.

## Management's Discussion and Analysis

of Financial Condition and Results of Operations (Continued)

**Interest Expense.** Interest expense decreased from \$5.0 million in 1998 to \$3.5 million in 1999. The decrease is due to lower average outstanding borrowings and lower interest rates.

**Income Tax Expense.** The effective income tax rate was 40.2% in 1999. See Note 6 of Notes to Consolidated Financial Statements for a reconciliation of the statutory tax rate to the Company's effective tax rate.

**Net Income.** In 1999, the Company's net income increased to \$61.4 million compared to a net income of \$61.0 million in 1998. Excluding the one-time Camelot merger-related costs, pro forma 1999 net income is \$76.6 million. The improved bottom line performance as compared to 1998 can be attributed to the improved leverage of SG&A expenses due to higher sales and the reduction of corporate overhead expenses.

### Fiscal Year Ended January 30, 1999 ("1998") Compared to Fiscal Year Ended January 31, 1998 ("1997")

**Sales.** The Company's sales increased \$711.1 million, or 124.5%, from 1997. The increase was primarily attributable to the retroactive effect of the acquisition of Camelot for the periods subsequent to its "fresh-start reporting" on January 31, 1998, upon its reemergence from bankruptcy, a comparable store sales increase of 7.5% and the sales increase resulting from the inclusion for a full year of 90 Strawberries' stores acquired in October 1997.

For 1998, comparable store sales increased 6.9% for mall stores and 9.7% for freestanding stores. By merchandise category, comparable store sales increased 6.6% in music, 10.2% in video and 10.2% in other merchandise.

**Gross Profit.** Gross profit, as a percentage of sales, increased to 37.9% in 1998 from 36.7% in 1997 as a result of reduced inventory shrinkage, increased purchase discounts and a strong performance from higher margin merchandise categories.

**Selling, General and Administrative Expenses.** SG&A, as a percentage of sales, decreased to 29.1% in 1998 from 29.9% in 1997. The 0.8% decrease can be attributed to the leverage of SG&A expenses on the increased sales.

**Impairment Charge and Restructuring Charge Reversal, net.** The impairment charge and restructuring charge reversal, net, represents a \$3.7 million charge taken related to the impairment of fixed assets at certain stores where the carrying amount of such assets exceeded their estimated fair value. This was offset by a one-time reversal of a \$2.2 million reserve remaining from the restructuring charges taken in 1995. The restructuring was completed during the fourth quarter of 1998.

**Interest Expense.** Interest expense decreased from \$5.1 million in 1997 to \$5.0 million in 1998. The decrease is due to lower average outstanding borrowings resulting from the equity offering in May 1998, partially offset by interest on long-term debt held by Camelot related to the Spec's acquisition.

**Income Tax Expense.** The effective income tax rate was 44.0% in 1998. See Note 6 of Notes to Consolidated Financial Statements for a reconciliation of the statutory tax rate to the Company's effective tax rate.

**Net Income.** In 1998, the Company's net income increased to \$61.0 million compared to a net income of \$20.6 million in 1997. The improved bottom line performance can be attributed to the merger with Camelot in April 1999 with "fresh-start reporting" effective for periods subsequent to January 31, 1998, and the profitability of the additional new stores opened in 1998. The merger with Camelot added \$20.4 million in net income in 1998. Also, the Company benefited from a comparable store sales increase, higher gross margin rate and improved SG&A leverage.

## Management's Discussion and Analysis

of Financial Condition and Results of Operations (Continued)

### LIQUIDITY AND CAPITAL RESOURCES

**Liquidity and Capital Resources.** The Company's primary sources of working capital are cash flow from operations and borrowings under its revolving credit facility. The Company ended fiscal 1999 with cash balances of approximately \$280.0 million, compared to \$139.4 million at the end of 1998. The increase was due to an increase in cash generated from operations. Cash provided by operations was \$212.1 million in 1999, compared to \$77.7 million in 1998. The increase was primarily related to improved inventory purchasing activities, as reflected by the net change in inventory and accounts payable. The net change in inventory and accounts payable was a net cash inflow of \$121.4 million in 1999, as compared to a net cash outflow of \$55.8 million in 1998. During 1999, the Company's accounts payable balance increased \$132.7 million, compared to an increase in the balance of \$17.8 million during 1998. The increase in accounts payable is due to improved payment terms for inventory purchased during the holiday season. Inventory increased \$11.3 million in 1999, as compared to a \$73.6 million increase in 1998. The large increase in inventory during 1998 was due to increased inventory requirements for stores acquired as part of the acquisitions of Spec's and The Wall.

Cash used in financing activities was \$18.2 million in 1999, as compared to a net cash inflow of \$38.5 million in 1998. In 1999, the primary uses of cash were a payment of \$22.0 million to payoff the remaining debt associated with the Spec's acquisition and \$11.5 million to repurchase outstanding shares of the Company's common stock under a program authorized by the Board of Directors on January 7, 2000. As of January 29, 2000, the Company had purchased approximately 1.1 million shares of the 5.0 million shares authorized by the Board. During 1998, the two largest sources of cash were \$36.6 million received in a public offering of its common stock and \$25.0 million borrowed for the acquisition of Spec's, partially offset by a \$38.3 million repayment of long-term debt.

The Company has a three-year \$100 million secured revolving credit facility with Congress Financial Corporation that expires in July 2000 and automatically renews on a year-to-year basis thereafter at the discretion of both parties. The Company fully expects to extend the current facility for three more years. The Revolving Credit Facility with its below prime average lending rate, combined with lower borrowing needs, was responsible for the Company's interest expense decreasing to \$3.5 million in 1999 from \$5.0 in 1998. As of January 29, 2000 and January 30, 1999, the Company had \$0 and \$20.0 million of long-term borrowings outstanding, respectively.

The Revolving Credit Facility contains certain restrictive provisions, including provisions governing cash dividends and acquisitions, is collateralized by merchandise inventory and has a minimum net worth covenant. On January 29, 2000, the Company had no outstanding borrowings under the Revolving Credit Facility, and \$100 million was available.

**Capital Expenditures.** Most of the Company's capital expenditures are for new store expansion and the relocation of existing stores. The Company typically finances its capital expenditures through cash generated from operations. The Company may also receive financing from landlords in the form of construction allowances or rent concessions. Total capital expenditures were approximately \$51.2 million in 1999. This includes approximately \$9.9 million related to the installation of a new point-of-sale ("POS") system in the Camelot stores acquired in April 1999.

In fiscal 2000, the Company plans to spend approximately \$35.0 million, net of construction allowances, for additions to fixed assets.

**Seasonality.** The Company's business is highly seasonal, with the highest sales and earnings occurring in the fourth fiscal quarter. See Note 12 of the Notes to Consolidated Financial Statements for quarterly financial highlights.

**Accounting Policies.** Statement of Financial Accounting Standards (SFAS) No. 133, "Accounting for Derivative Instruments and Hedging Activities," issued in June 1998 and, as amended, effective for all quarters of fiscal years beginning after June 15, 2000, will require companies to recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. Management is currently evaluating the impact of SFAS No. 133 and anticipates the adoption will not have a material effect on the Company's consolidated financial statements.

## Management's Discussion and Analysis

of Financial Condition and Results of Operations (Continued)

The Accounting Standards Executive Committee Statement of Position 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use," issued in March 1998 and effective for fiscal years beginning after December 15, 1998, requires that certain costs of computer software developed or obtained for internal use be capitalized. The Company adopted this statement for the fiscal year beginning January 31, 1999. There was no impact on the Company's results of operations or financial position because it did not develop any new software internally, nor did it purchase any software.

The Accounting Standards Executive Committee Statement of Position 98-5, "Accounting for the Costs of Start-up Activities," issued in April 1998 and effective for fiscal years beginning after December 15, 1998, requires start-up costs and organization costs to be expensed as incurred. The Company adopted this statement for the fiscal year beginning January 31, 1999. There was no impact on the Company's results of operations or financial position because such costs were already being expensed as incurred.

**Dividend Policy.** The Company has never declared or paid cash dividends on its Common Stock. The Company's credit agreement currently allows the Company to pay a cash dividend once in each calendar year. These dividends are restricted to ten percent of the most recent fiscal year's consolidated net income and can only be paid if, after any payment of dividends, the Company maintains \$25 million of availability under the credit agreement. Any future determination as to the payment of dividends would depend upon capital requirements and limitations imposed by the Company's credit agreement and such other factors as the board of directors of the Company may consider.

## Consolidated Balance Sheets

<b>ASSETS</b>	<b>January 29, 2000</b>	<b>January 30, 1999</b>
	<i>(in thousands)</i>	
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$280,026	\$139,411
Accounts receivable	5,973	5,800
Merchandise inventory	437,363	426,078
Deferred tax asset	—	633
Prepaid expenses and other	5,203	9,382
Total current assets	728,565	581,304
FIXED ASSETS, net	144,694	139,124
DEFERRED TAX ASSET	34,431	29,580
GOODWILL	31,433	33,026
OTHER ASSETS	17,287	15,576
TOTAL ASSETS	\$956,410	\$798,610
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$353,294	\$220,636
Income taxes payable	21,908	30,544
Accrued expenses and other	32,021	50,787
Deferred tax liability	12,469	—
Current portion of long-term debt and capital lease obligations	5,311	4,802
Total current liabilities	425,003	306,769
LONG-TERM DEBT, less current portion	—	20,000
CAPITAL LEASE OBLIGATIONS, less current portion	19,461	16,065
OTHER LIABILITIES	17,773	23,400
TOTAL LIABILITIES	462,237	366,234
<b>SHAREHOLDERS' EQUITY:</b>		
Preferred stock (\$0.01 par value; 5,000,000 shares authorized; None issued)	—	—
Common stock (\$0.01 par value; 200,000,000 shares authorized; 53,425,867 shares and 52,182,408 shares issued in 1999 and 1998, respectively)	534	522
Additional paid-in capital	283,932	271,805
Unearned compensation – restricted stock	(348)	(78)
Treasury stock at cost (1,177,432 and 105,432 shares in 1999 and 1998, respectively)	(11,855)	(390)
Retained earnings	221,910	160,517
TOTAL SHAREHOLDERS' EQUITY	494,173	432,376
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$956,410	\$798,610

See Notes to Consolidated Financial Statements.

## Consolidated Statements of Income

	January 29, 2000	Fiscal Year Ended January 30, 1999	January 31, 1998
<i>(in thousands, except per share amounts)</i>			
Sales	\$1,358,132	\$1,282,385	\$571,314
Cost of sales	858,588	796,311	361,422
Gross profit	499,544	486,074	209,892
Selling, general and administrative expenses	371,998	372,886	170,834
Camelot merger-related costs, net	25,473	—	—
Asset impairment charge and restructuring charge reversal, net	—	1,537	—
Income from operations	102,073	111,651	39,058
Interest expense	3,496	4,989	5,148
Other expense (income), net	(4,086)	(2,221)	(153)
Income before income taxes	102,663	108,883	34,063
Income tax expense	41,270	47,873	13,489
NET INCOME	\$ 61,393	\$ 61,010	\$ 20,574
BASIC EARNINGS PER SHARE	\$ 1.17	\$ 1.19	\$ 0.70
Weighted average number of common shares outstanding – basic	52,457	51,105	29,483
DILUTED EARNINGS PER SHARE	\$ 1.15	\$ 1.14	\$ 0.66
Weighted average number of common shares outstanding – diluted	53,354	53,530	31,032

See Notes to Consolidated Financial Statements.

## Consolidated Statements of Shareholders' Equity

	<u>Common Stock</u>		Additional	Unearned	Treasury	Retained	Shareholders'
	Shares	Amount	Paid in	Compensation	Stock	Earnings	Equity
			Capital	Stock Plans			
	<i>(in thousands)</i>						
Balance as of February 1, 1997	29,429	\$294	\$ 24,344	\$ (245)	\$ (407)	\$ 78,933	\$102,919
Issuance of treasury stock under incentive stock programs	—	—	—	—	13	—	13
Amortization of unearned compensation – restricted stock	—	—	—	70	—	—	70
Exercise of stock options and related tax benefit	294	3	943	—	—	—	946
Net Income	—	—	—	—	—	20,574	20,574
Balance as of January 31, 1998 as previously reported	29,723	297	25,287	(175)	(394)	99,507	124,522
Opening equity balances of Camelot upon adoption of “fresh-start” accounting	19,301	193	194,175	—	—	—	194,368
Balance as of January 31, 1998, as restated	49,024	490	219,462	(175)	(394)	99,507	318,890
Issuance of treasury stock under incentive stock programs	—	—	10	—	4	—	14
Stock issued	—	—	188	—	—	—	188
Issuance of shares of common stock in a public offering	2,250	23	36,600	—	—	—	36,623
Amortization of unearned compensation – restricted stock	—	—	—	44	—	—	44
Issuance of director stock options	—	—	346	—	—	—	346
Issuance of options under Camelot 1998 Stock Option Plan	—	—	5,112	(5,112)	—	—	—
Amortization of unearned compensation – Camelot 1998 Stock Option Plan	—	—	—	5,112	—	—	5,112
Forfeiture of unearned compensation – restricted stock	—	—	(53)	53	—	—	—
Exercise of stock options and related tax benefit	908	9	10,140	—	—	—	10,149
Net Income	—	—	—	—	—	61,010	61,010
Balance as of January 30, 1999	52,182	522	271,805	(78)	(390)	160,517	432,376
Issuance of treasury stock under incentive stock programs	—	—	9	—	4	—	13
Repurchase of shares of treasury stock	—	—	—	—	(11,469)	—	(11,469)
Issuance of restricted stock under incentive stock programs	30	—	336	(336)	—	—	—
Amortization of unearned compensation – restricted stock	—	—	—	66	—	—	66
Issuance of director stock options	—	—	64	—	—	—	64
Exercise of stock options and related tax benefit	1,214	12	11,718	—	—	—	11,730
Net Income	—	—	—	—	—	61,393	61,393
Balance as of January 29, 2000	53,426	\$534	\$283,932	\$ (348)	\$(11,855)	\$221,910	\$494,173

See Notes to Consolidated Financial Statements.

## Consolidated Statements of Cash Flows

	January 29, 2000	Fiscal Year Ended January 30, 1999	January 31, 1998
	<i>(in thousands)</i>		
<b>OPERATING ACTIVITIES:</b>			
Net income	\$ 61,393	\$ 61,010	\$ 20,574
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	37,709	35,478	16,257
Amortization of financing fees	—	253	—
Amortization of lease valuations, net	(2,765)	(388)	—
Reversal of restructuring charge	—	(2,157)	—
Loss on impairment from fixed assets	6,649	3,694	—
Stock compensation programs	143	5,568	83
Loss on disposal of assets	3,670	1,560	—
Deferred tax expense	8,251	4,529	1,370
Changes in operating assets and liabilities:			
Accounts receivable	(173)	(773)	5,868
Merchandise inventory	(11,285)	(73,557)	(9,872)
Prepaid expenses and other	4,179	(1,422)	(408)
Other assets	(1,272)	178	2,481
Accounts payable	132,658	17,788	42,751
Income taxes payable	(6,261)	26,461	12,119
Accrued expenses and other	(18,766)	5,884	7,344
Store closing reserve	—	(6,535)	(5,056)
Other liabilities	(1,996)	135	198
Net cash provided by operating activities	212,134	77,706	93,709
<b>INVESTING ACTIVITIES:</b>			
Acquisition of property and equipment	(51,234)	(57,143)	(15,538)
Acquisition of businesses, net	—	(103,264)	(20,901)
Other assets and liabilities, net	(2,100)	(235)	—
Disposal of videocassette rental inventory, net of purchases	23	2,860	685
Net cash used by investing activities	(53,311)	(157,782)	(35,754)
<b>FINANCING ACTIVITIES:</b>			
Payments of long-term debt and financing fees	(22,000)	(38,281)	(18,440)
Proceeds from long-term debt	—	25,000	—
Payments of capital lease obligations	(4,036)	(1,292)	(99)
Proceeds from capital lease	9,941	13,651	—
Payments for purchases of treasury stock	(11,469)	—	—
Proceeds from public offering of common stock	—	36,623	—
Exercise of stock options	9,356	2,750	545
Net cash provided (used) by financing activities	(18,208)	38,451	(17,994)
Opening cash balance of Camelot upon adoption of “fresh-start” accounting	—	86,304	—
Net increase (decrease) in cash and cash equivalents	140,615	(41,625)	39,961
Cash and cash equivalents, beginning of year	139,411	94,732	54,771
Cash and cash equivalents, end of year	\$280,026	\$139,411	\$ 94,732
Supplemental disclosure of non-cash investing and financing activities:			
Issuance of treasury stock under incentive stock programs	\$ 13	\$ 14	\$ 13
Issuance of restricted shares under restricted stock plan	336	—	—
Income tax benefit resulting from exercises of stock options	2,374	7,347	400

See Notes to Consolidated Financial Statements.

## Notes to Consolidated Financial Statements

### Note 1. Nature of Operations and Summary of Significant Accounting Policies

**Nature of Operations:** Trans World Entertainment Corporation is one of the largest specialty retailers of music, video and related accessories in the United States. The Company operates in a single industry segment, the operation of a chain of retail entertainment stores. At January 29, 2000, the Company operated 967 stores in 44 states, the District of Columbia, Commonwealth of Puerto Rico and the U.S. Virgin Islands, with a majority of the stores concentrated in the eastern half of the United States.

**Basis of Presentation:** The consolidated financial statements consist of Trans World Entertainment Corporation, its wholly owned subsidiary, Record Town, Inc. ("Record Town"), and Record Town's subsidiaries, all of which are wholly owned. All significant intercompany accounts and transactions have been eliminated. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. On April 22, 1999, the Company merged with Camelot Music Holdings, Inc. ("Camelot"). The transaction was accounted for as a pooling-of-interests. Accordingly, prior period consolidated financial statements have been restated to include combined results of operations, financial position and cash flows of Camelot as though it had been a part of the Company since Camelot's adoption of "fresh-start" accounting on January 31, 1998.

**Fiscal Year:** The Company's fiscal year is a 52 or 53-week period ending on the Saturday nearest to January 31. Fiscal 1999, 1998 and 1997 ended January 29, 2000, January 30, 1999 and January 31, 1998, respectively, and each fiscal year consisted of 52 weeks.

**Revenue Recognition:** Revenue from sales of merchandise is recognized at the point of sale to the consumer, at which time payment is tendered. There are no provisions for uncollectible amounts since payment is received at the time of sale.

**Cash and Cash Equivalents:** The Company considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

**Concentration of Credit Risks:** The Company maintains centralized cash management and investment programs whereby excess cash balances are invested in short-term funds and money market instruments considered to be cash equivalents. The Company's investment portfolio is diversified and consists of short-term investment grade securities consistent with its investment guidelines. These guidelines include the provision that sufficient liquidity will be maintained to meet anticipated cash flow needs. The Company maintains cash and cash equivalents with various major financial institutions. At times, such amounts may exceed the F.D.I.C. limits. The Company limits the amount of credit exposure with any one financial institution and believes that no significant concentration of credit risk exists with respect to cash investments.

**Concentration of Business Risks:** The Company purchases inventory for its stores from approximately 500 suppliers, with approximately 73% of purchases being made from five suppliers. In the past, the Company has not experienced difficulty in obtaining satisfactory sources of supply, and management believes that it will retain access to adequate sources of supply. However, a loss of a major supplier could cause a loss of sales, which would have an adverse effect on operating results and also result in a decrease in vendor support for the Company's advertising programs.

**Merchandise Inventory and Return Costs:** Inventory is stated at the lower of cost or market as determined principally by the average cost method. The Company is entitled to return merchandise purchased from major vendors for credit against other purchases from these vendors. The vendors often reduce the credit with a merchandise return charge ranging from 0% to 20% of the original merchandise purchase price depending on the type of merchandise being returned. The Company records the merchandise return charges in cost of sales.

## Notes to Consolidated Financial Statements

(Continued)

### Note 1. Nature of Operations and Summary of Significant Accounting Policies (cont'd)

**Videocassette Rental Inventory:** The cost of videocassette rental tapes is capitalized and amortized on a straight-line basis over their estimated economic life with a provision for salvage value. Major movie release additions, which have a relatively short economic life due to the frequency of rental, are amortized over twelve months, while other titles are amortized over thirty-six months. Depreciation and amortization expense related to the Company's videocassette rental inventory totaling \$921,000, \$1.2 million and \$2.2 million in fiscal 1999, 1998 and 1997, respectively, is included in cost of sales.

**Fixed Assets and Depreciation:** Fixed assets are stated at cost. Major improvements and betterments to existing facilities and equipment are capitalized. Expenditures for maintenance and repairs that do not extend the life of the applicable asset are charged to expense as incurred. Buildings are depreciated over a 30-year term. Fixtures and equipment are depreciated using the straight-line method over their estimated useful lives, which range from three to seven years. Leasehold improvements are amortized using the straight-line method over the shorter of their estimated useful life or the related lease term. Primarily all of the Company's operating leases are ten years in term. Amortization of capital lease assets is included in depreciation and amortization expense.

**Fair Value of Long-Lived Assets:** Fixed assets and other long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. During fiscal 1999, the Company recorded an impairment loss of \$6.7 million as part of the Camelot merger charge for the write-down of certain fixed assets acquired in the merger. During fiscal 1998, the Company recorded an impairment loss of \$3.7 million to write-down the carrying amount of fixed assets, primarily leasehold improvements, at stores where the estimated future cash flows through the end of the store's lease were less than the carrying amount of that store's fixed assets.

**Goodwill:** Goodwill represents the adjusted amount of the cost of acquisitions in excess of fair value of net assets acquired in purchase transactions, and is being amortized on a straight-line basis over estimated useful lives ranging from fifteen to twenty years. The amortization period is determined by taking into consideration the following factors: the critical market position and establishment of brand names; the combined store mass of the companies; the amortization periods generally used in the retail music business; the highly competitive nature of the business including emerging forms of competition; and the overall history of profitability of the acquired businesses.

**Advertising Costs:** The costs of advertising are expensed in the first period in which such advertising takes place. Total advertising expense was \$18.8 million, \$19.2 million and \$8.4 million in fiscal 1999, 1998 and 1997, respectively.

**Store Opening and Closing Costs:** Costs associated with opening a store are expensed as incurred. When it is determined that a store will be closed, estimated unrecoverable costs are charged to expense. Such costs include the net book value of abandoned fixtures, equipment, leasehold improvements and a provision for lease obligations, less estimated sub-rental income. The residual value of any fixed asset moved to a store as part of a relocation is transferred to the relocated store.

**Income Taxes:** Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

## Notes to Consolidated Financial Statements

(Continued)

### Note 1. Nature of Operations and Summary of Significant Accounting Policies (cont'd)

**Earnings Per Share:** The Company accounts for earnings per share under the provisions of Statement of Financial Accounting Standards (SFAS) No. 128, "Earnings per Share." This standard requires the Company to disclose basic earnings per share and diluted earnings per share. Basic earnings per share is calculated by dividing net income by weighted average common shares outstanding. Diluted earnings per share is calculated by dividing net income by the sum of the weighted average shares outstanding and additional common shares that would have been outstanding if the dilutive potential common shares, adjusted in fiscal 1999 and 1998 for the \$2.4 million and \$7.3 million, respectively, tax benefit resulting from stock option exercise activity, had been issued for the Company's common stock options from the Company's Stock Option Plans (see Note 9). In fiscal 1999, 1998 and 1997, the additional dilutive potential common shares were 0.9 million, 2.4 million and 1.5 million, respectively. As required by SFAS No. 128, all outstanding common stock options were included even though their exercise may be contingent upon vesting.

**Fair Value of Financial Instruments:** The carrying amounts reported in the consolidated balance sheets for cash and cash equivalents, accounts receivable, accounts payable and other current liabilities approximate fair value because of the immediate or short-term maturity of these financial instruments. The carrying value of long-term debt approximates fair value because its variable interest rate is adjusted to the current market rate on a monthly basis.

**Comprehensive Income:** The Company does not have other items of comprehensive income as defined by SFAS No. 130, "Reporting Comprehensive Income." Accordingly, comprehensive income is equal to net income.

**Reclassifications:** Certain amounts in prior years' financial statements have been reclassified to conform with the current year presentation.

### Note 2. Business Combinations

On April 22, 1999, under an Agreement and Plan of Merger dated October 26, 1998, the Company acquired Camelot, a specialty retailer of prerecorded music, videocassettes and DVDs, and related accessories, in a stock-for-stock transaction accounted for as a pooling-of-interests. Camelot operated over 480 retail locations in 38 states, the District of Columbia and the Commonwealth of Puerto Rico. Upon completion of the merger, Camelot became a wholly owned subsidiary of the Company. In the merger, each share of Camelot's common stock was converted into 1.9 shares of the Company's common stock. Each outstanding option to purchase Camelot common stock immediately prior to the completion of the merger was converted into 1.9 fully vested and exercisable options to acquire the Company's common stock. The exercise prices of these options were adjusted accordingly for the 1.9 to 1 conversion ratio. As a result, the Company issued approximately 19.3 million shares of its common stock and converted 1.3 million options to acquire its common stock. In connection with the merger, all of Camelot's outstanding notes payable were repaid.

Effective July 29, 1998, the Camelot acquired all of the outstanding common stock of Spec's Music, Inc. ("Spec's") under the terms of an Agreement and Plan of Merger dated June 3, 1998. Spec's was a retailer of prerecorded music stores in South Florida and Puerto Rico. The Spec's acquisition was accounted for as a purchase. The total purchase price was \$42.7 million, net of cash acquired, including cash payment of \$18.6 million, repayment of Spec's indebtedness of \$9.2 million, assumption of liabilities aggregating \$14 million and acquisition costs of \$900,000. The excess of the purchase price over the fair values of the net assets acquired (goodwill) of \$9.4 million is being amortized on a straight-line basis over 20 years.

Effective February 28, 1998, the Camelot acquired certain assets and assumed certain liabilities and operating lease commitments of The Wall Music, Inc. ("The Wall") pursuant to an Asset Purchase Agreement dated December 10, 1997. The purchase price of The Wall was \$74.6 million, net of cash acquired, (including approximately \$2.3 million of acquisition costs) and was paid in cash. The acquisition was accounted for as a purchase, with the excess purchase price over fair values of the net assets acquired (goodwill) of \$24.7 million being amortized on a straight-line basis over 20 years.

## Notes to Consolidated Financial Statements

(Continued)

### Note 2. Business Combinations (cont'd)

Effective October 8, 1997, the Company acquired 90 out of a total of 118 stores owned by Strawberries, Inc., a privately held freestanding music specialty retailer operating primarily in New England. The stores operate under the names "Strawberries" and "Waxie Maxie" and are primarily located in freestanding or strip center locations. The acquisition has been accounted for using the purchase method of accounting. At the time of the acquisition, the Company paid \$21 million for the assets which included the fixed assets, merchandise inventories, other related current assets and \$683,000 in goodwill. This goodwill is being amortized on a straight-line basis over a 15-year period.

### Note 3. Restructuring Charge

The Company completed its 1995 restructuring program in fiscal 1998. The remaining balance in the store closing reserve of \$2.2 million was credited to operations in the fourth quarter of fiscal 1998.

### Note 4. Property, Plant and Equipment

	January 29, 2000	January 30, 1999
Buildings	\$ 18,926	\$ 19,530
Fixtures and equipment	166,229	148,752
Leasehold improvements	99,903	94,828
	285,058	263,110
Allowances for depreciation and amortization	(140,364)	(123,986)
	\$ 144,694	\$ 139,124

Depreciation and amortization expense related to the Company's distribution center facility and equipment of \$1.6 million, \$1.6 million and \$1.1 million in fiscal 1999, 1998 and 1997, respectively, is included in cost of sales. All other depreciation and amortization of fixed assets is included in selling, general and administrative expenses. Depreciation and amortization of fixed assets is included in the condensed consolidated statements of income as follows:

	1999	Fiscal Year 1998	1997
	<i>(in thousands)</i>		
Cost of sales	\$ 1,612	\$ 1,567	\$ 1,101
Selling, general and administrative expenses	\$33,732	\$30,552	\$15,141

### Note 5. Debt

The Company's \$100.0 million secured revolving credit facility with Congress Financial Corporation matures in July 2000 and automatically renews on a year-to-year basis thereafter at the discretion of both parties. The Company fully expects to extend the current facility for three more years. The facility bears interest at the prime interest rate or the Eurodollar interest rate plus 1.75% (7.97% at January 29, 2000), and is collateralized by the Company's assets, allowing the Company to borrow up to 65% of its eligible merchandise inventory to a maximum of \$100.0 million.

During fiscal 1999, 1998 and 1997, the highest aggregate balances outstanding under the current and previous revolving credit facilities were \$3.3 million, \$35.0 million and \$45.9 million, respectively. The weighted average interest rates during fiscal 1999, 1998 and 1997 based on average daily balances were 7.44%, 8.50% and 8.58%, respectively. The balances outstanding under the Company's revolving credit agreements at the end of fiscal 1999 and 1998 were \$0.

Interest paid during fiscal 1999, 1998 and 1997 was approximately \$3.6 million, \$4.4 million and \$5.8 million, respectively.

## Notes to Consolidated Financial Statements

(Continued)

### Note 5. Debt (cont'd)

On April 22, 1999, upon completion of the merger, the Company paid off and terminated the amended Camelot Revolving Credit Agreement, which had been in effect since June 12, 1998. The amended facility provided for working capital loans of up to \$50 million during the peak period (October through December) and up to \$35 million during the non-peak period (including in each case up to \$5 million of letters of credit). In no case could the amount of loans exceed the borrowing base, which was 60% of eligible inventory. Camelot had \$35 million of availability at January 30, 1999. The amended Revolving Credit Agreement also provided the ability to obtain a \$25 million term loan to finance the Spec's acquisition. The term loan (drawn against effective July 29, 1998), which bore the same interest rate terms as the working capital portion of the Revolving Credit Agreement, was fully repaid upon completion of the Camelot acquisition.

### Note 6. Income Taxes

Income tax expense consists of the following:

	1999	Fiscal Year 1998	1997
		<i>(in thousands)</i>	
Federal – current	\$30,498	\$36,207	\$10,813
State – current	2,521	7,137	1,306
Deferred	8,251	4,529	1,370
	<b>\$41,270</b>	<b>\$47,873</b>	<b>\$13,489</b>

A reconciliation of the Company's effective tax rates with the federal statutory rate is as follows:

	1999	Fiscal Year 1998	1997
Federal statutory rate	35.0%	35.0%	35.0%
State income taxes, net of federal income tax effect	1.4%	4.4%	3.0%
Unearned compensation – stock options	—	1.9%	—
Plan of reorganization adjustments	—	2.2%	—
Merger costs	3.6%	—	—
Other	0.2%	0.5%	1.6%
Effective income tax rate	<b>40.2%</b>	<b>44.0%</b>	<b>39.6%</b>

## Notes to Consolidated Financial Statements

(Continued)

**Note 6. Income Taxes (cont'd)**

Significant components of the Company's deferred tax assets and liabilities are as follows:

	January 29, 2000	January 30, 1999
<i>(in thousands)</i>		
<b>CURRENT DEFERRED TAX ASSETS</b>		
Accruals	\$ 1,570	\$ 2,803
Other	36	286
Total Current Deferred Tax Asset	1,606	3,089
<b>CURRENT DEFERRED TAX LIABILITIES</b>		
Inventory	13,632	2,078
Prepaid expenses	443	378
Total Current Deferred Tax Liabilities	14,075	2,456
Net Current Deferred Tax Asset (Liability)	(\$12,469)	\$ 633
<b>NON-CURRENT DEFERRED TAX ASSETS</b>		
Tax over book asset basis	\$20,911	\$18,441
Federal and state net operating loss carryforwards	6,804	4,421
Accrued rent	4,448	2,877
Lease values	1,663	1,809
Capitalized leases	882	914
Executive retirement plan	1,336	252
Accruals	890	1,300
Amortization	344	1,062
Compensation related	87	107
Other	73	1,054
Total Non-Current Deferred Tax Assets	37,438	32,237
<b>NON-CURRENT DEFERRED TAX LIABILITIES</b>		
Goodwill	3,007	2,657
Total Non-Current Deferred Tax Liabilities	\$ 3,007	\$ 2,657
Net Non-Current Deferred Tax Asset	\$34,431	\$29,580
<b>TOTAL NET DEFERRED TAX ASSET</b>	<b>\$21,962</b>	<b>\$30,213</b>

At January 29, 2000 and January 30, 1999, the Company had gross deferred tax assets of \$39.0 million and \$35.3 million, respectively, and gross deferred tax liabilities of \$17.1 million and \$5.1 million, respectively. The Company had a net operating loss carryforward of \$10.0 million for Federal income tax purposes for fiscal 1999 and 1998, and \$71.3 million and \$17.9 million for state income tax purposes for fiscal 1999 and 1998, respectively, that expire at various times through 2013 and are subject to certain limitations.

In assessing the propriety of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment. Based upon the level of projected future taxable income over the periods in which the deferred tax assets are deductible, management believes it is more likely than not that the Company will realize the benefits of those deductible differences. The amount of the deferred tax asset considered realizable could be reduced if estimates of future taxable income during the carryforward period are reduced.

The Company paid income taxes of approximately \$39.3 million, \$17.1 million and \$300,000 during fiscal 1999, 1998 and 1997, respectively.

## Notes to Consolidated Financial Statements

(Continued)

### Note 7. Commitments and Contingencies

The Company is party to various claims, legal actions and complaints arising in the ordinary course of its business, including pre-petition assessments by the Internal Revenue Service ("IRS") aggregating approximately \$7.9 million and relating to Camelot's corporate-owned life insurance program. No judgment has been rendered regarding these IRS assessments as of January 29, 2000. A trial to decide the matter began in March 2000 in the Federal District Court for the District of Delaware. A decision is expected to be rendered in the third or fourth quarter of fiscal 2000. In the event that a judgment is rendered against the Company in the full amount of the proposed assessment, the Company's results of operations would be materially adversely affected with a charge to earnings of approximately \$7.9 million plus interest since January 1998. In the opinion of management, the IRS assessments and all other claims, legal actions and complaints are without merit or involve such amounts that unfavorable disposition will not have a material impact on the financial position, results of operations or cash flows of the Company.

### Note 8. Leases

As more fully discussed in Note 11, the Company leases its distribution center and administrative offices under three capital leases with its Chief Executive Officer and largest shareholder. The Company also has a capital lease for its point-of-sale system.

Fixed asset amounts for capital leases, which are included in the fixed assets on the accompanying balance sheets, are as follows:

	January 29, 2000	January 30, 1999
	<i>(in thousands)</i>	
Buildings	\$ 9,342	\$ 9,342
Fixtures and equipment	26,890	16,061
	36,232	25,403
Allowances for depreciation and amortization	(10,729)	(6,312)
	<b>\$25,503</b>	<b>\$19,091</b>

The Company leases substantially all of its stores, many of which contain renewal options, for periods ranging from five to twenty-five years, with the majority being ten years. Most leases also provide for payment of operating expenses, real estate taxes and for additional rent based on a percentage of sales.

Net rental expense was as follows:

	1999	Fiscal Year 1998	1997
	<i>(in thousands)</i>		
Minimum rentals	\$108,818	\$102,130	\$ 50,237
Contingent rentals	2,957	1,310	719
	<b>\$111,775</b>	<b>\$103,440</b>	<b>\$ 50,956</b>

## Notes to Consolidated Financial Statements

(Continued)

### Note 8. Leases (cont'd)

Future minimum rental payments required under all leases that have initial or remaining non-cancelable lease terms in excess of one year at January 29, 2000 are as follows:

	Operating Leases	Capital Leases
	<i>(in thousands)</i>	
2000	\$103,668	\$ 7,807
2001	94,873	7,807
2002	85,918	6,318
2003	75,248	2,994
2004	60,312	1,679
Thereafter	159,733	18,075
Total minimum payments required	<u>\$579,752</u>	44,680
Less: amounts representing interest		19,908
Present value of minimum lease payments		24,772
Less: current portion		5,311
Long-term capital lease obligations		<u>\$19,461</u>

### Note 9. Benefit Plans

#### 401(k) Savings Plan

The Company offers a 401(k) Savings Plan to eligible employees meeting certain age and service requirements. This plan permits participants to contribute up to 20% of their salary, including bonuses, up to the maximum allowable by Internal Revenue Service regulations. Participants are immediately vested in their voluntary contributions plus actual earnings thereon. Participant vesting of the Company's matching and profit sharing contribution is based on the years of service completed by the participant. Participants are fully vested upon the completion of four years of service. All participant forfeitures of non-vested benefits are used to reduce the Company's contributions in future years. The Company matching contribution totaled \$962,000, \$1.1 million and \$529,000 in fiscal 1999, 1998 and 1997, respectively.

#### Stock Option Plans

The Company has four employee stock option plans, the 1986 Stock Option Plan, the 1994 Stock Option Plan, the 1998 Stock Option Plan and the 1999 Stock Option Plan (the "Plans"). The Compensation Committee of the Board of Directors may grant options to acquire shares of common stock to employees of the Company and its subsidiaries at the fair market value of the common stock on the date of grant. Under the Plans, options generally become exercisable commencing one year from the date of grant in increments of 25% per year with a maximum term of ten years. Options authorized for issuance under the Plans totaled 12.3 million. The Company stopped issuing stock options under the 1986 Stock Option Plan as of June 1, 1995. At January 29, 2000, of the 10.8 million remaining options authorized for issuance under the Plans, 4.5 million have been granted and are outstanding, 1.6 million of which were vested and exercisable. Options available for future grants at January 29, 2000 and January 30, 1999 were 3.3 million and 2.5 million, respectively.

Under the terms of the Camelot merger agreement, all options issued under the Camelot 1998 Stock Option Plan (the "Camelot Plan") were converted to Trans World options. The Camelot Plan provided for the granting of either incentive stock options or nonqualified stock options to purchase shares of the Company's common stock. Vesting of the options was originally over a four-year period with a maximum term of ten years. Based on the terms of the Camelot Plan, vesting was accelerated based on the market performance of the Company's common stock whereby 50% of the options vested on March 13, 1998. The remaining 50% vested on April 22, 1999 in connection with the merger. At January 29, 2000, 530,500 options were outstanding and exercisable. The Company stopped issuing stock options under the Camelot Stock Option Plan as of April 22, 1999. The Company recognized \$5.1 million in compensation expense during 1998 related to stock options granted below the market price at the date of the grant and accelerated vesting.

## Notes to Consolidated Financial Statements

(Continued)

**Note 9. Benefit Plans (cont'd)**

The following table summarizes information about the stock options outstanding under the Plans and the Camelot Plan at January 29, 2000:

Exercise Price Range	Outstanding			Exercisable	
	Shares	Average Remaining Life	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
\$1.21-\$2.67	1,150,524	6.1	\$ 1.61	745,884	\$ 1.52
2.68-5.33	567,552	6.1	4.17	311,052	4.32
5.34-10.67	10,000	10.0	10.00	0	0.00
10.68-13.33	2,183,700	8.4	11.34	957,700	11.05
13.34-16.00	725,050	9.2	15.18	25,300	14.02
16.01-18.67	414,561	8.2	17.84	94,680	17.82
18.68-21.33	5,000	8.7	19.75	1,250	19.75
21.34-24.00	2,000	8.9	23.75	500	23.75
24.01-26.67	6,000	8.4	25.79	1,500	25.79
Total	<u>5,064,387</u>	7.7	\$ 9.44	<u>2,137,766</u>	\$ 7.10

The Company also has a stock option plan for non-employee directors (the "1990 Plan"). Options under this plan are granted at 85% of the fair value at the date of grant. Under the 1990 Plan, options generally become exercisable commencing one year from the date of grant in increments of 25% per year with a maximum term of ten years. As of January 29, 2000, there were 750,000 options authorized for issuance and 280,750 options have been granted and are outstanding, 194,435 of which were vested and exercisable. There are 439,250 shares of common stock reserved for possible future option grants under the 1990 Plan.

Under the terms of the Camelot merger agreement, all options issued under the Camelot Outside Director Stock Option Plan (the "Camelot Director Plan") were converted to Trans World options. As of January 29, 2000, there were 4,750 options outstanding and exercisable under the Camelot Director Plan. During 1998, the Company recognized \$234,000 in compensation expense based on the market value of the stock on the date of grant in June 1998 in connection with the initial grant of stock options under the Camelot Director Plan. The Company no longer issues options under the Camelot Director Plan.

The following table summarizes information about the stock options outstanding under the two Director Plans at January 29, 2000:

Exercise Price Range	Outstanding			Exercisable	
	Shares	Average Remaining Life	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
\$1.19-\$2.67	49,500	6.3	\$ 1.64	38,625	\$ 1.58
2.68-5.33	138,000	4.8	3.46	101,250	3.57
5.34-8.00	18,000	2.0	6.10	18,000	6.10
8.01-10.67	45,000	3.1	9.49	33,750	9.26
10.68-13.33	23,750	9.1	12.24	4,750	10.92
13.34-15.12	11,250	8.3	15.12	2,810	15.12
Total	<u>285,500</u>	5.1	\$ 5.45	<u>199,185</u>	\$ 4.71

## Notes to Consolidated Financial Statements

(Continued)

## Note 9. Benefit Plans (cont'd)

The following table summarizes activity under the Stock Option Plans:

	Employee Stock Option Plans			Director Stock Option Plans		
	Number of Shares Subject To Option	Option Price Range Per Share	Weighted Average Exercise Price	Number of Shares Subject To Option	Option Price Range Per Share	Weighted Average Exercise Price
Balance February 1, 1997	3,139,696	\$0.75-\$6.17	\$2.12	210,000	\$1.19-\$9.14	\$5.28
Granted	2,865,500	3.33-11.20	9.42	103,500	2.09-3.37	2.86
Exercised	(285,086)	0.96-3.67	1.74	(7,500)	3.69	3.69
Canceled	(203,514)	0.96-4.58	1.79	(48,000)	3.33-9.14	7.57
Balance January 31, 1998	5,516,596	\$0.75-\$11.20	\$5.94	258,000	\$1.19-\$9.14	\$3.93
Granted	529,600	13.88-26.67	17.61	50,000	10.20-15.12	11.65
Exercised	(885,043)	0.75-10.92	3.08	(22,500)	2.09-3.68	3.15
Canceled	(259,134)	1.21-17.79	4.64	—	—	—
Balance January 30, 1999	4,902,019	\$0.75-\$26.67	\$7.79	285,500	\$1.19-\$15.12	\$5.34
Granted	1,501,000	10.00-15.25	13.42	29,000	12.22-12.96	12.45
Exercised	(1,194,899)	0.75-17.79	7.65	(19,000)	10.92	10.92
Canceled	(143,733)	0.75-17.79	9.65	(10,000)	12.22	12.22
Balance January 29, 2000	5,064,387	\$1.21-\$26.67	\$9.44	285,500	\$1.19-\$15.12	\$5.45

The per share weighted average fair value of the stock options granted during fiscal 1999, 1998 and 1997 was \$5.01, \$6.48 and \$2.82, respectively, using the Black Scholes option pricing model, with the following weighted average assumptions:

1999 – expected dividend yield 0.0%, risk-free interest rate of 6.47%, expected life of five years and stock volatility of 72%;

1998 – expected dividend yield 0.0%, risk-free interest rate of 5.15%, expected life of five years and stock volatility of 70%;

1997 – expected dividend yield 0.0%, risk-free interest rate of 6.7%, expected life of five years and stock volatility of 48%.

The Company applies APB Opinion No. 25 in accounting for its Plans and, accordingly, no compensation cost has been recognized for its stock options in the financial statements for employee stock options, which are issued at the closing stock price on the day of grant. During fiscal 1999, 1998 and 1997, the Company recognized expenses of \$64,000, \$57,000 and \$52,000, respectively, for stock options issued to non-employee directors at 85% of the closing stock price on the date of grant. Had the Company determined compensation cost for employee stock options based on fair value in accordance with SFAS No. 123, the Company's net income would have been reduced to the pro forma amounts indicated below:

	1999	Fiscal Year 1998	1997
	<i>(in thousands, except per share amounts)</i>		
Net income, as reported	\$61,393	\$61,010	\$20,574
Basic earnings per share, as reported	\$ 1.17	\$ 1.19	\$ 0.70
Diluted earnings per share, as reported	\$ 1.15	\$ 1.14	\$ 0.66
Pro forma net income	\$57,621	\$59,016	\$19,168
Pro forma basic earnings per share	\$ 1.10	\$ 1.15	\$ 0.65
Pro forma diluted earnings per share	\$ 1.08	\$ 1.10	\$ 0.62

**Notes to Consolidated Financial Statements**

(Continued)

**Note 9. Benefit Plans (cont'd)****Restricted Stock Plan**

Under the 1990 Restricted Stock Plan, the Compensation Committee of the Board of Directors is authorized to grant awards for up to 900,000 restricted shares of common stock to executive officers and other key employees of the Company and its subsidiaries. The shares are issued as restricted stock and are held in the custody of the Company until all vesting restrictions are satisfied. If conditions or terms under which an award is granted are not satisfied, the shares are forfeited. Shares begin to vest under these grants after three years and are fully vested after five years, with vesting criteria which includes continuous employment until applicable vesting dates have expired. At January 29, 2000, a total of 255,000 shares have been granted, of which 75,000 were granted in fiscal 1996 with a weighted average grant date fair market value of \$1.58, aggregating a total value of \$118,750; an additional 150,000 were granted in fiscal 1995 with a weighted average grant date fair value of \$1.55 per share, aggregating a total of \$232,500 and an additional 30,000 were granted in fiscal 1999 with a weighted average grant date fair value of \$11.19, aggregating a total of \$335,625. As of January 29, 2000, a total of 120,000 of these shares had vested and 30,000 shares with an unamortized unearned compensation balance of \$53,000, had been forfeited. Unearned compensation is recorded at the date of award, based on the market value of the shares, and is included as a separate component of shareholders' equity and is amortized over the applicable vesting period. The amount amortized to expense in fiscal 1999, 1998 and 1997 was approximately \$66,000, \$44,000 and \$70,000, respectively. At January 29, 2000, outstanding awards and shares available for grant totaled 105,000 and 675,000, respectively.

**Supplemental Executive Retirement Plan**

The executive officers of the Company have a non-qualified Supplemental Executive Retirement Plan (SERP). The SERP, which is unfunded, provides eligible executives defined pension benefits that supplement benefits under other retirement arrangements. The annual benefit amount has been predetermined as part of the plan and vests based on years of service and age at retirement. For fiscal 1999, 1998 and 1997, expenses related to the plan totaled approximately \$481,000, \$342,000 and \$361,000, respectively. The present value of the projected benefit obligation was approximately \$3.6 million at January 29, 2000. The January 29, 2000 consolidated balance sheet includes \$3.6 million of accrued expense for the SERP and a \$2.5 million intangible asset for unrecognized prior service costs.

**Note 10. Shareholders' Equity**

On May 1, 1998, the Company sold an additional 2.25 (adjusted) million shares of its common stock in a public offering for approximately \$36.6 million, net of issuance costs. A portion of the proceeds was used to repay long-term debt and the balance of the proceeds was used for general corporate purposes including investments in additional stores, fixtures and inventory.

On July 31, 1998, the Board of Directors approved a three-for-two common stock split to be distributed in the form of a 50% stock dividend. As a result, 10,937,104 shares were issued on September 15, 1998 to shareholders of record on September 1, 1998. Accordingly, amounts equal to the par value of the additional shares issued have been charged to additional paid in capital and credited to common stock. All references throughout these financial statements to number of shares, per share amounts, stock option data and market prices of the Company's common stock have been adjusted to reflect this stock split.

On January 7, 2000, the Board of Directors approved a stock repurchase plan authorizing the purchase of up to 5 million shares of the Company's common stock. As of January 29, 2000, the Company had purchased approximately 1.1 million shares of the 5 million shares authorized by the Board. At January 29, 2000 and January 30, 1999, the Company held 1,177,432 and 105,432 shares, respectively, in treasury stock.

## Notes to Consolidated Financial Statements

(Continued)

### Note 11. Related Party Transactions

The Company leases its 168,400 square foot distribution center/office facility in Albany, New York from Robert J. Higgins, its Chairman, Chief Executive Officer and largest shareholder, under three capitalized leases that expire in the year 2015. The original distribution center/office facility was constructed in 1985. A 77,100 square foot distribution center expansion was completed in October 1989 on real property adjoining the existing facility. A 19,100 square foot expansion was completed in September 1998 adjoining the existing facility.

Under the three capitalized leases, dated April 1, 1985, November 1, 1989 and September 1, 1998 (the "Leases"), the Company paid Mr. Higgins an annual rent of \$1.6 million, \$1.4 million and \$1.3 million in fiscal 1999, 1998 and 1997, respectively. On January 1, 2000, the aggregate rental payment increased in accordance with the biennial increase in the Consumer Price Index, pursuant to the provisions of each lease. Effective January 1, 2002, and every two years thereafter, the rental payment increases in accordance with the biennial increase in the Consumer Price Index, pursuant to the provisions of the lease. None of the leases contains any real property purchase option at the expiration of its term. Under the terms of the Leases, the Company pays all property taxes, insurance and other operating costs with respect to the premises. Mr. Higgins' obligation for principal and interest on his underlying indebtedness relating to the real property is approximately \$1.1 million per year.

The Company leases two of its retail stores from Mr. Higgins under long-term leases. Under the first store lease, annual rent payments were \$40,000 in fiscal 1999 and 1998 and \$35,000 in fiscal 1997. Under the second store lease, annual rent payments were \$35,000 in fiscal 1999, 1998 and 1997. Under the terms of the leases, the Company pays property taxes, maintenance and a contingent rental if a specified sales level is achieved. Total additional charges for both locations, including contingent rent, was approximately \$17,700, \$18,100 and \$16,900 in fiscal 1999, 1998 and 1997, respectively. In fiscal 1998 and 1997, the Company paid Mr. Higgins \$30,000 under one-year operating leases expiring on October 31, 1998 and October 31, 1997, respectively, for certain parking facilities contiguous to the Company's distribution center/office facility. This lease was not renewed upon its expiration on October 31, 1998.

The Company regularly utilizes a privately chartered aircraft owned or partially owned by Mr. Higgins. Under an unwritten agreement with Quail Aero Services of Syracuse, Inc., a corporation in which Mr. Higgins is a one-third shareholder, the Company paid \$110,000, \$65,000 and \$59,000 for chartered aircraft services in fiscal 1999, 1998 and 1997, respectively. The Company also charters an aircraft from Crystal Jet, a corporation wholly owned by Mr. Higgins. Payments to Crystal Jet aggregated \$64,000, \$180,000 and \$199,000 in fiscal 1999, 1998 and 1997, respectively. The Company also charters an aircraft from Richmor Aviation, an unaffiliated corporation that leases an aircraft owned by Mr. Higgins. Payments to Richmor Aviation in fiscal 1999, 1998 and 1997 were \$325,000, \$0 and \$0, respectively. The Company believes that the charter rates and terms are as favorable to the Company as those generally available to it from other commercial charters.

The transactions that were entered into with an "interested director" were approved by a majority of disinterested directors of the Board of Directors, either by the Audit Committee or at a meeting of the Board of Directors. The Board of Directors believes that the leases and other provisions are at rates and on terms that are at least as favorable as those that would have been available to the Company from unaffiliated third parties under the circumstances.

In September 1999, in connection with his hiring as President and Chief Operating Officer, the Company made a \$200,000 interest-free loan to Michael J. Madden.

## Notes to Consolidated Financial Statements

(Continued)

## Note 12. Quarterly Financial Information (Unaudited)

	1999	1/29/99	Fiscal 1999 Quarter Ended		5/1/99
			10/30/99	7/31/99	
	<i>(in thousands, except per share amounts)</i>				
Sales	\$1,358,132	\$517,870	\$275,968	\$277,275	\$287,019
Gross profit	499,544	195,049	96,981	102,570	104,944
Net income (loss)	61,393	60,569	3,777	5,691	(8,644)
Basic earnings (loss) per share	\$ 1.17	\$ 1.15	\$ 0.07	\$ 0.11	\$ (0.17)
Diluted earnings (loss) per share	\$ 1.15	\$ 1.12	\$ 0.07	\$ 0.11	\$ (0.17)

	1998	1/30/99	Fiscal 1998 Quarter Ended		5/2/98
			10/31/98	8/1/98	
	<i>(in thousands, except per share amounts)</i>				
Sales	\$1,282,385	\$497,735	\$270,706	\$262,561	\$251,383
Gross profit	486,074	198,410	101,439	95,812	90,413
Net income	61,010	51,532	3,743	3,574	2,161
Basic earnings per share	\$ 1.19	\$ 1.01	\$ 0.07	\$ 0.07	\$ 0.04
Diluted earnings per share	\$ 1.14	\$ 0.97	\$ 0.07	\$ 0.07	\$ 0.04

## Report of KPMG LLP

(Independent Auditors)

The Board of Directors and Shareholders  
Trans World Entertainment Corporation:

We have audited the accompanying consolidated balance sheets of Trans World Entertainment Corporation and subsidiaries as of January 29, 2000 and January 30, 1999, and the related consolidated statements of income, shareholders' equity and cash flows for each of the fiscal years in the three-year period ended January 29, 2000. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Trans World Entertainment Corporation and subsidiaries as of January 29, 2000 and January 30, 1999, and the results of their operations and their cash flows for each of the fiscal years in the three-year period ended January 29, 2000, in conformity with generally accepted accounting principles.

**KPMG LLP**

Albany, New York  
March 17, 2000

## Board of Directors and Executive Officers



**Robert J. Higgins**  
Chairman and  
Chief Executive Officer



**Dean S. Adler**  
Director; Principal,  
Lubert/Adler Partners, L.P.



**George W. Dougan†**  
Director; Director,  
BankNorth Group, Inc.



**Charlotte G. Fischer\***  
Director; Former Chairman,  
President and Chief  
Executive Officer,  
Paul Harris Stores, Inc.



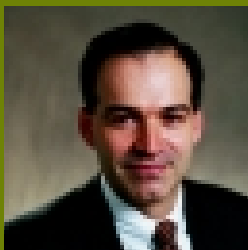
**Martin E. Hanaka†**  
Director; Chairman,  
Chief Executive Officer,  
The Sports Authority



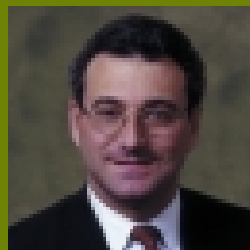
**Isaac Kaufman\*†**  
Director; Chief Financial  
Officer, Multi-Specialty  
Healthcare Group



**Matthew H. Mataraso**  
Secretary and Director;  
Attorney



**Dr. Joseph G. Morone\***  
Director; President,  
Bentley College



**Michael Solow**  
Partner and Practice  
Manager, Hopkins  
and Sutter

### Executive Officers

**Michael J. Madden** President and Chief Operating Officer

**Bruce J. Eisenberg** Senior Vice President – Real Estate

**John J. Sullivan** Senior Vice President – Finance and Chief Financial Officer

**Corporate Office** 38 Corporate Circle, Albany, NY 12203

**Independent Auditors** KPMG LLP, Albany, NY

**Transfer Agent** ChaseMellon Shareholder Services, New York, NY

**Annual Meeting** June 16, 2000, 10:00 a.m., The Desmond, Albany, NY

A copy of the Company's Annual Report on Form 10-K for the fiscal year ended January 29, 2000 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

Design: Media Logic, Inc. Photography: Laszlo Regos & Michael Gallitelli

