CELLSTAR CORP
Form 10-Q
July 13, 2001

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended May 31, 2001
or
[_] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from___________to____________

Commission File Number 0-22972

CELLSTAR CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	75-2479727
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1730 Briercroft Court
Carrollton, Texas 75006
Telephone (972) 466-5000

(Address, including zip code and telephone number,
including area code, of registrant's principal executive offices)

Indicate by check mark whether the registrant (1) has filed all reports to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No _____

On July 9, 2001, there were 60,142,221 outstanding shares of Common Stock, $0.01 par value per share.

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CELLSTAR CORPORATION
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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

CellStar Corporation and Subsidiaries
Consolidated Balance Sheets
(Unaudited)
(Amounts in thousands, except share data)

Assets

Current Assets:
Cash and cash equivalents
Restricted cash
Accounts receivable (less allowance for doubtful accounts of $56,813 and $75,810, respectively)

Inventories
Deferred income tax assets
Prepaid expenses

Total current assets

Property and equipment, net
Goodwill (less accumulated amortization of $6,695 and $17,408, respectively)
Deferred income tax assets
Other assets

Liabilities and Stockholders' Equity

Current liabilities:
Accounts payable
Notes payable
Accrued expenses
Income taxes payable
Deferred income tax liabilities

Total current liabilities
Long-term debt

Total liabilities

Stockholders' equity:
Preferred stock, $.01 par value, 5,000,000 shares authorized;
none issued
Common stock, $.01 par value, 200,000,000 shares authorized;
60,142,221 shares issued and outstanding
Additional paid-in capital
Accumulated other comprehensive loss - foreign currency
translation adjustments
Retained earnings

Total stockholders' equity

See accompanying notes to unaudited consolidated financial statements.

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CellStar Corporation and Subsidiaries
Consolidated Statements of Operations
(Unaudited)
(Amounts in thousands, except per share data)

	Three months ended May 31,		Six ended
	2001	2000	2001
Revenues	$ 572,328	561,370	1,217,486
Cost of sales	537,673	558,233	1,146,038
Gross profit	34,655	3,137	71,448
Selling, general and administrative expenses	23,238	58,059	52,172
Restructuring charge (credit)	750	-	750
Operating income (loss)	10,667	(54,922)	18,526
Other income (expense):			
Equity in loss of affiliated companies	-	(466)	(700
Gain on sale of assets	-	-	933
Interest expense	(3,875)	(4,702)	(8,964
Other, net	815	182	3,555
Total other income (expense)	(3,060)	(4,986)	(5,176
Income (loss) before income taxes	7,607	(59,908)	13,350
Provision (benefit) for income taxes	2,321	(17,484)	3,872
Net income (loss)	$ 5,286	(42,424)	9,478
Net income (loss) per share:			
Basic	$ 0.09	(0.71)	0.16
Diluted	$ 0.09	(0.71)	0.16

See accompanying notes to unaudited consolidated financial statements.

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CellStar Corporation and Subsidiaries
Consolidated Statement of Stockholders' Equity and Comprehensive Income
Six months ended May 31, 2001
(Unaudited)
(In thousands)

	Common Stock		Additional paid-in capital	Accumu other comp los
	Shares	Amount		
Balance at November 30, 2000	60,142	$ 602	81,298	(10,
Comprehensive income:				
Net income		-	-	
Foreign currency translation adjustment		-	-	(3,
Total comprehensive income				
Balance at May 31, 2001	60,142	$ 602	81,298	(13,

See accompanying notes to unaudited consolidated financial statements.

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CellStar Corporation and Subsidiaries
Consolidated Statements of Cash Flows
Six months ended May 31, 2001 and 2000
(Unaudited)
(In thousands)

Cash flows from operating activities:	
Net income (loss)	$
Adjustments to reconcile net income to net cash provided by (used in) operating activities:	
Depreciation and amortization	
Equity in loss of affiliated companies	
Gain on sale of assets	
Deferred income taxes	
Changes in operating assets and liabilities net of effects from disposition of business:	
Accounts receivable	
Inventories	
Prepaid expenses	
Other assets	
Accounts payable	(
Accrued expenses	
Income taxes payable	
Net cash provided by (used in) operating activities	
Cash flows from investing activities:	
Proceeds from sale of assets	
Change in restricted cash	
Purchases of property and equipment	
Acquisition of business, net of cash acquired	
Purchase of investment	
Investment in joint venture	

Net cash provided by (used in) investing activities

Cash flows from financing activities:
Net borrowings (repayments) on notes payable
Additions to deferred loan costs
Net proceeds from issuance of common stock

Net cash provided by (used in) financing activities

Net decrease in cash and cash equivalents
Cash and cash equivalents at beginning of period

Cash and cash equivalents at end of period $

See accompanying notes to unaudited consolidated financial statements.

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CellStar Corporation and Subsidiaries
Notes to Consolidated Financial Statements
(Unaudited)

(1) Basis of Presentation

Although the interim consolidated financial statements of CellStar Corporation and subsidiaries (the "Company") are unaudited, Company management is of the opinion that all adjustments (consisting of only normal recurring adjustments) necessary for a fair statement of the results have been reflected therein. Operating revenues and net income for any interim period are not necessarily indicative of results that may be expected for the entire year.

These statements should be read in conjunction with the consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K/A Amendment No. 2 for the year ended November 30, 2000.

Certain prior period financial statement amounts have been reclassified to conform to the current year presentation.

(2) Net Income Per Share

Basic net income per common share is based on the weighted average number of common shares outstanding for the relevant period. Diluted net income per common share is based on the weighted average number of common shares outstanding plus the dilutive effect of potentially issuable common shares pursuant to stock options and convertible notes.

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A reconciliation of the numerators and denominators of the basic and diluted net income per share computations for the three and six months ended May 31, 2001 and 2000, follows (in thousands, except per share data):

	Three months ended May 31,	
	2001	2000
Basic:		
Net income (loss)	$ 5,286	(4
Weighted average number of shares outstanding	60,142	6
Net income (loss) per share	$ 0.09	
Diluted:		
Net income (loss)	$ 5,286	(4
Interest on convertible notes, net of tax effect	-	
Adjusted net income (loss)	$ 5,286	(4
Weighted average number of shares outstanding	60,142	6
Effect of dilutive securities:		
Stock options	1	
Convertible notes	-	
Weighted average number of shares outstanding including effect of dilutive securities	60,143	6
Net income (loss) per share	$ 0.09	

	Six months ended May 31,	
	2001	20
Basic:		
Net income (loss)	$ 9,478	(3
Weighted average number of shares outstanding	60,142	6
Net income (loss) per share	$ 0.16	
Diluted:		
Net income (loss)	$ 9,478	(3
Interest on convertible notes, net of tax effect	-	
Adjusted net income (loss)	$ 9,478	(3
Weighted average number of shares outstanding	60,142	6
Effect of dilutive securities:		
Stock options	2	
Convertible notes	-	

Weighted average number of shares outstanding including effect of dilutive securities	60,144	6
Net income (loss) per share	$ 0.16	

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Options outstanding at May 31, 2001, to purchase 6.1 million and 5.7 million shares of common stock for the three and six months ended May 31, 2001 were not included in the computation of diluted earnings per share (EPS) because their inclusion would have been anti-dilutive.

Options outstanding to purchase 5.4 million shares of common stock for the three and six months ended May 31, 2000, respectively were not included in the computation of diluted EPS because their inclusion would have been anti-dilutive.

The subordinated convertible notes were not dilutive for the three and six month periods ended May 31, 2001 and 2000, respectively.

(3) Segment and Related Information

The Company operates predominately within one industry, wholesale and retail sales of wireless telecommunications products. The Company's management evaluates operations primarily on income before interest and income taxes in the following reportable geographical regions: Asia-Pacific, North America, Latin America, which includes Mexico and the Company's Miami, Florida operations ("Miami"), and Europe. Revenues and operating results of Miami are included in Latin America since Miami's activities are primarily for export customers. The Corporate segment includes headquarter operations, primarily general and administrative costs, and income and expenses not allocated to reportable segments. Corporate segment assets primarily consist of cash, cash equivalents and deferred income tax assets. Intersegment sales and transfers are not significant.

Segment asset information as of May 31, 2001, and November 30, 2000, follows (in thousands):

	Asia-Pacific	North America	Latin America	Europe
Total assets				
May 31, 2001	$ 278,483	95,037	132,135	45,649
November 30, 2000	289,677	172,527	256,907	56,824

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Segment operations information for the three and six months ended May 31, 2001 and 2000, follows (in thousands):

	Asia-Pacific	North America	Latin America	Europe
Three months ended May 31, 2001:				
Revenues from external customers	$ 308,983	104,983	98,579	59,783
Income (loss) before interest and income taxes	9,116	6,789	390	(1,224)
Three months ended May 31, 2000:				
Revenues from external customers	231,388	102,953	160,526	66,503
Income (loss) before interest and income taxes	1,461	(19,962)	(28,095)	(3,654)

Income (loss) before interest and income taxes per segment information......................
Interest expense per the consolidated statements of operations..............................
Interest income included in other, net in the consolidated statements of operations..........

Income (loss) before income taxes per the consolidated statements of operations..............

	Asia-Pacific	North America	Latin America	Europe
Six months ended May 31, 2001:				
Revenues from external customers	$ 607,505	251,505	237,647	120,829
Income (loss) before interest and income taxes	13,588	11,067	3,579	(1,103)
Six months ended May 31, 2000:				
Revenues from external customers	473,306	180,410	315,732	181,781
Income (loss) before interest and income taxes	13,183	(19,117)	(23,072)	(960)

Income (loss) before interest and income taxes per segment information.....................
Interest expense per the consolidated statements of operations.............................
Interest income included in other, net in the consolidated statements of operations.........

Income (loss) before income taxes per the consolidated statements of operations............

(4) Notes Payable

Notes payable consisted of the following at May 31, 2001 and November 30, 2000 (in thousands):

	2001	2000
Multicurrency revolving credit facility	$ 16,081	82,700
People's Republic of China ("PRC") credit facilities	30,776	44,428
Taiwan note payable	8,009	-
Peru note payable	2,842	2,842
	$ 57,708	129,970

As of January 30, 2001, the Company had negotiated an amendment to its Multicurrency Revolving Credit Facility, (the"Facility") that reduced the amount of the Facility from $100.0 million to $86.4 million.

On February 27, 2001, the Company and its banking syndicate negotiated and executed a Second Amended and Restated Credit Agreement that further reduced the amount of the Facility to $85.0 million on February 27, 2001, $74.0 million on July 31, 2001, $65.0 million on September 30, 2001, and $50.0 million on December 15, 2001. Such Second Amended and Restated Credit Agreement further (i) increases the applicable interest rate margin by 25 basis points, (ii) shortens the term of the Facility from June 1, 2002 to March 1, 2002, (iii) provides additional collateral for such Facility in the form of additional stock pledges and mortgages on real property, (iv) provides for dominion of funds by the banks for the Company's U.S. operations, (v) limits the borrowing base, and (vi) tightens restrictions on the Company's ability to fund its operations, particularly its non-U.S. operations.

As of July 3, 2001, the Company had negotiated an additional amendment to its Facility that reduced the borrowing capacity under the Facility from $85.0 million to $40.0 million and waived compliance with a covenant for the quarter ended May 31, 2001.

At July 9, 2001 the Company had available $29.5 million of unused borrowing capacity under the Facility.

At May 31, 2001, the Company's operations in the PRC had three lines of credit, one for USD $12.5 million, the second for RMB 215 million (approximately USD $26.0 million) and the third for RMB 50 million (approximately USD $6.0 million), bearing interest at 7.16%, 5.85% and 2.34% respectively. The loans have maturity dates through August 2001. The first two lines of credit are fully collateralized by U.S. dollar cash deposits. The cash deposits were made via intercompany loans from the operating entity in Hong Kong as a mechanism to secure repatriation of these funds. The third line of credit is supported by a RMB 15.0 million cash collateral deposit and a promissory note. At May 31, 2001, the U.S. dollar equivalent of $30.8 million had been borrowed against the lines of credit in the PRC. As a result of this method of funding operations in the PRC, the consolidated balance sheet at May 31, 2001 reflects USD $41.3 million in cash that is restricted as collateral on these advances and a corresponding USD $30.8 million in notes payable.

Based upon current and anticipated levels of operations, and aggressive efforts to reduce inventories and accounts receivable, the Company anticipates that its cash flow from operations, together with amounts available under its Facility and existing unrestricted cash balances,

will be adequate to meet its anticipated cash requirements in the foreseeable future. In the event that existing unrestricted cash balances, cash flows and available borrowings under the Facility are not sufficient to meet future cash requirements, the Company may be required to reduce planned expenditures or seek additional financing. The Company can provide no assurances that reductions in planned expenditures would be sufficient to cover shortfalls in available cash or that additional financing would be available or, if available, offered on terms acceptable to the Company.

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(5) Accounting for Derivative Instruments and Hedging Activities

In June 1998, the Financial Accounting Standards Board issued Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("Statement 133"), amended by Statement 138 issued in June 2000. Effective December 1, 2000, the Company adopted Statement 133. Given the Company's current derivative activities, the adoption of Statement 133 did not have a material effect on the Company's consolidated financial position and results of operations.

The Company uses various derivative financial instruments as part of an overall strategy to manage the Company's exposure to market risk associated with interest rate and foreign currency exchange rate fluctuations. The Company evaluates the use of interest rate swaps and cap agreements to manage its interest risk on debt instruments, including the reset of interest rates on variable rate debt.

The Company periodically uses foreign currency forward contracts to reduce exposure to exchange rate risks primarily associated with transactions in the regular course of the Company's international operations. The Company consolidates the bulk of its foreign exchange exposure related to intercompany transactions in its international finance subsidiary. The forward contracts establish the exchange rates at which the Company purchases or sells the contracted amount of local currencies for specified foreign currencies at a future date. The Company uses forward contracts, which are short-term in nature (45 days to one year), and receives or pays the difference between the contracted forward rate and the exchange rate at the settlement date.

At May 31, 2001, the Company had French franc forward contracts with a contractual amount of $5.6 million. The carrying amount and fair value of these contracts are not significant. These derivatives are not accounted for as hedges under Statement 133.

The Company does not hold or issue derivative financial instruments for trading purposes.

(6) Contingencies

Refer to Part II, Item 1, "Legal Proceedings".

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

The Company reported net income of $5.3 million, or $0.09 per diluted share, for the second quarter of 2001, compared with a net loss of $42.4 million, or $0.71 per diluted share, for the same quarter last year. Revenues for the quarter ended May 31, 2001, were $572.3 million, an increase of $10.9 million compared to $561.4 million in 2000. Gross profit increased from $3.1 million in 2000 to $34.7 million in 2001. Selling, general and administrative expenses for the second quarter of 2001 were $23.2 million compared to $58.1 million in 2000. In the second quarter of 2000, the Company decided to divest its majority interest in its Brazil joint venture, phase out a major portion of its North America and Miami redistributor business, and substantially reduce international trading operations conducted by its U.K. subsidiary due to third party theft and fraud losses. During the second quarter of 2000, the Company recorded inventory obsolescence expense of $21.8 million, bad debt expense of $25.5 million, and $3.2 million in theft and fraud losses related to the U.K. international trading operations.

The Company announced on July 6, 2001, that Alan H. Goldfield retired effective immediately from the position of Chairman and CEO and that James L. "Rocky" Johnson, who has served on the Board of Directors since March 1994 will become non-executive Chairman of the Board, and Terry S. Parker, a member of the Board of Directors and a former President and COO of CellStar, will be rejoining the Company as Chief Executive Officer. Pursuant to the terms of Alan H. Goldfield's separation agreement filed herewith, the Company expects to incur a charge in the range of $5.0 million during the third quarter of 2001.

Cautionary Statements

The Company's success will depend upon, among other things, its ability to maintain its operating margins, continue to secure an adequate supply of competitive products on a timely basis and on commercially reasonable terms, service its indebtedness and comply with covenants, secure adequate financial resources, continually turn its inventories and accounts receivable, successfully manage growth (including monitoring operations, controlling costs, maintaining adequate information systems and effective inventory and credit controls), manage operations that are geographically dispersed, achieve significant penetration in existing and new geographic markets, and hire, train and retain qualified employees who can effectively manage and operate its business.

The Company's foreign operations are subject to various political and economic risks including, but not limited to, the following: political instability; economic instability; currency controls; currency devaluations; exchange rate fluctuations; potentially unstable channels of distribution; increased credit risks; export control laws that might limit the markets the Company can enter; inflation; changes in laws related to foreign ownership of businesses abroad; foreign tax laws; changes in cost of and access to capital; changes in import/export regulations, including enforcement policies; "gray market" resales; and tariff and freight rates. Political and other factors beyond the control of the Company, including trade disputes among nations or internal political or economic instability in any nation where the Company conducts business, could have a material adverse effect on the Company.

Special Cautionary Notice Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements relating to such matters as anticipated financial performance and business prospects. When used in the Quarterly Report, the words "estimates", "may",

"intends", "expects", "anticipates", "could", "should", "will" and similar expressions are intended to be among the statements that identify forward-looking statements. From time to time, the Company may also publish forward-looking statements. The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. In order to comply with the terms of the safe harbor, the Company notes that a variety of factors, including foreign customer and vendor relationships, seasonality, inventory obsolescence and availability, "gray market" resales, and inflation could cause the Company's actual results and experience to differ materially from anticipated results or other expectations expressed in the Company's forward-looking statements.

Results of Operations

The following table sets forth certain unaudited consolidated statements of operations data for the Company expressed as a percentage of revenues for the three and six months ended May 31, 2001 and 2000:

	Three months ended May 31,		Six months ended May 31,	
	2001	2000	2001	2000
Revenues	100.0 %	100.0	100.0	100.0
Cost of Sales	93.9	99.5	94.1	95.5
Gross profit	6.1	0.5	5.9	4.5
Selling, general and administrative expenses	4.1	10.3	4.3	7.8
Restructuring charge (credit)	0.1	-	0.1	-
Operating income (loss)	1.9	(9.8)	1.5	(3.3)
Other income (expense):				
Equity in loss of affiliated companies	-	(0.1)	(0.1)	-
Gain on sale of assets	-	-	0.1	-
Interest expense	(0.7)	(0.8)	(0.7)	(0.8)
Other, net	0.1	-	0.3	-
Total other income (expense)	(0.6)	(0.9)	(0.4)	(0.8)
Income (loss) before income taxes	1.3	(10.7)	1.1	(4.1)
Provision (benefit) for income taxes	0.4	(3.1)	0.3	(1.3)
Net income (loss)	0.9 %	(7.6)	0.8	(2.8)

Three Months Ended May 31, 2001 Compared to Three Months Ended May 31, 2000

Revenues. The Company's revenues increased $10.9 million, or 2.0%, from $561.4 million to $572.3 million.

Revenues in the Asia-Pacific Region increased $77.6 million, or 33.5%, from $231.4 million to $309.0 million. The Company's operations in the People's Republic of China, including Hong Kong ("PRC"), provided $271.7 million in revenues, an increase of $118.5 million, or 77.3%, from

$153.2 million. Growth in the PRC, where market penetration of handsets is very low, is being driven by the rapid addition of new wireless subscribers. Revenues from the Company's operations in Singapore increased $11.0 million to $21.5 million, or 105.5%, due to new products, including two products for which the Company has exclusive rights. Revenues from Taiwan and The Philippines operations decreased $43.2 million, or 88.5%, and $8.8 million, or 46.2%, respectively, to $5.6 million and $10.2 million, respectively. The Company's operations in Taiwan and The Philippines continue to be affected by economic and political turmoil in the respective countries.

North American Region revenues were $105.0 million, an increase of $2.0 million compared to $103.0 million in 2000. Early in the first quarter of 2001, the Company converted a major U.S. account to a consignment basis with fulfillment fees, which will reduce revenue potential for the 2001 fiscal year by approximately $100 million. Revenues for the second quarter of 2000 on a comparable basis were $89.5 million. The conversion to consignment is expected to have minimal impact on net income, but will reduce inventory risk and the need for working capital.

The Company's operations in the Latin America Region provided $98.6 million of revenues, compared to $160.5 million in 2000, a 38.6% decrease. Revenues in Mexico, the region's largest revenue contributor, were $66.4 million compared to $100.0 million in 2000, which benefited from strong carrier promotions. The decrease was also due to a delay in 2001 in new-subscriber and promotional activities by a large carrier customer. The Company sold its 51% interest in its Brazil joint venture in August 2000. Revenues for Brazil were $12.5 million in last year's second quarter. Revenues from the Venezuela operations were $8.9 million in 2000. The Company sold its Venezuela operations in December 2000. Revenues from the Company's Miami export operations were $13.5 million compared to $20.5 million in the second quarter a year ago, reflecting the Company's decision last year to phase out a major portion of its redistributor channel and the increased availability of in-country manufactured products in South America, which has reduced sales to exporters by Miami. As a result, the Company restructured its Miami operation to reduce the size and cost of these operations, resulting in a charge of $0.8 million in the second quarter of 2001. Combined revenues from CellStar's Argentina, Chile, Colombia and Peru operations were $18.7 million in 2001 and $18.8 million in 2000.

The Company's European Region operations recorded revenues of $59.8 million, a decrease of $6.7 million from $66.5 million in 2000. The handset market in Europe is highly penetrated and is increasingly driven by replacement sales, which are depressed due to delays in the rollout of new handset technologies and services.

Gross Profit. Gross profit increased $31.6 million from $3.1 million to $34.7 million. In the second quarter of 2000, the Company incurred $21.8 million in inventory obsolescence, primarily as a result of price declines. Also during the second quarter of 2000, the Company recorded $3.2 million in third party theft and fraud losses related to the U.K. international trading operations. Gross profit as a percentage of revenues increased due to better inventory management and product mix.

Selling, General and Administrative Expenses. Selling, general and administrative expenses decreased $34.8 million from $58.1 million to $23.2 million. This decrease was principally due to a reduction in bad debt expense of $27.3 million. Bad debt expense in 2000 was $25.5 million and was primarily from certain U.S.-based accounts receivable, the collectibility of which had deteriorated significantly in the second quarter of 2000 and which were further affected by the Company's decision

to sell its majority interest in its joint venture in Brazil and the phase out of a major portion of the redistributor business in its Miami and North America operations. Bad debt expense in 2001, includes a recovery of $3.9 million related to a receivable from a satellite handset customer, which was reserved in

the fourth quarter of 2000. Selling, general and administrative expenses related to the Brazil and Venezuela operations, which were sold in August 2000 and December 2000, respectively, were $6.3 million in 2000.

Restructuring Charge (Credit). In connection with its previously announced intent, the Company restructured its Miami facilities in the second quarter of 2001 to reduce the size and cost of those operations, resulting in a charge of $0.8 million, primarily related to the impairment of leasehold improvements.

Equity in Loss of Affiliated Companies. Equity in loss of affiliated companies was $0.5 million in 2000 due to losses from the Company's 49% minority interest in CellStar Amtel. As a result of the continuing deterioration in the Malaysia market, the Company intends to divest its ownership in CellStar Amtel to limit further exposure. The Company will be required to recognize future losses, if any, of CellStar Amtel up to the amount of debt and payables of CellStar Amtel guaranteed by the Company. The Company currently estimates the remaining exposure to be up to $1.0 million.

Interest Expense. Interest expense decreased to $3.9 million from $4.7 million. This decrease was primarily related to the elimination of debt of the Brazil operation, which was sold in August 2000. The decrease was also a result of lower borrowing levels on the Company's Multicurrency Revolving Credit Facility.

Other, Net. Other, net increased $0.6 million, from income of $0.2 million to income of $0.8 million, primarily due to losses in the second quarter of 2000 on foreign currencies related to European operations.

Income Taxes. Income tax expense increased from a benefit of $17.5 million to an expense of $2.3 million. The Company's annual effective tax rate decreased to 29.0% from 30.5% The lower effective tax rate was attributable to changes in the expected geographical mix of income (loss) before income taxes.

Six Months Ended May 31, 2001 Compared to Six Months Ended May 31, 2000

Revenues. The Company's revenues increased $66.3 million, or 5.8%, from $1,151.2 million to $1,217.5 million.

Revenues in the Asia-Pacific Region increased $134.2 million, or 28.4%, from $473.3 million to $607.5 million. The Company's operations in the PRC provided $526.0 million in revenue, an increase of $204.8 million, or 63.8%, from $321.2 million. This increase was due to continued strong demand in the PRC and the build-up of extensive sales channels. Growth in the PRC, where market penetration of handsets is very low, is being driven by the rapid addition of new wireless subscribers. Revenues from the Company's operations in Singapore increased $19.8 million, or 105.8%, to

$38.5 million due to third party subsidies and new products, including two products for which the Company has exclusive rights. Revenues from Taiwan and The Philippines operations decreased $82.4 million, or 80.5%, and $8.0 million, or 25.7%, respectively to $19.9 million and $23.1 million, respectively. The Company's operations in Taiwan and The Philippines continue to be affected by economic and political turmoil in the respective countries.

North American Region revenues were $251.5 million, an increase of $71.1 million, or 39.4% when compared to $180.4 million. U.S. revenues continued to benefit from strong promotional activity by several customers, as well as from the addition of new customers and expanded markets. Early in the first quarter of 2001, the Company converted a major U.S. account to a consignment basis with fulfillment fees, which will reduce revenue potential for the 2001 fiscal year by approximately $100 million. Revenues for the six months ended May 31, 2001 and May 31, 2000, on a comparable basis were $233.2 million and $161.6 million, respectively. The conversion to consignment is expected to have minimal impact on net income, but will reduce inventory risk and the need for working capital.

The Latin American Region provided $237.6 million of revenues, compared to $315.7 million, or a 24.7% decrease. Revenues in Mexico decreased $40.4 from $182.8 million in 2000, which benefited from strong carrier promotions, to $142.4 million in 2001. The decrease was also due to a delay in 2001 in new-subscriber and promotional activities by a large carrier customer. Revenues for Brazil were $25.7 million in 2000. The Company's sold its Brazil operations in August 2000. Revenues from the Venezuela operations were $26.4 million in 2000. The Company sold its Venezuela operations in December 2000. Revenues from the Company's operations in Miami decreased $17.9 million from 2000 as increased product availability from in-country manufacturers in Latin America continued to reduce export sales from Miami. The Company phased out a major portion of its redistributor business in its Miami and North American operations due to the volatility of the redistributor business, the relatively lower margins, and higher credit risks. Combined revenues from the operations in Argentina, Chile, Colombia and Peru increased $31.0 million to $69.8 million primarily due to significant promotional activity by a major carrier in Colombia during the first quarter of 2001.

The Company's Europe Region recorded revenues of $120.8 million, a decrease of $61.0 million, or 33.5%, from $181.8 million, primarily due to the Company's decision to curtail its U.K. international trading operations in April 2000 (see "International Operations"). The handset market in Europe is highly penetrated and is increasingly driven by replacement sales, which are depressed due to delays in the rollout of new handset technologies and services.

Gross Profit. Gross profit increased $20.0 million from $51.4 million to $71.4 million. During 2000, the Company incurred $23.5 million in inventory obsolescence primarily as a result of price declines during the second quarter and $3.2 million in third party theft and fraud losses related to the U.K. international trading operations. Excluding the above items in 2000, the decrease in gross profit as a percentage of revenues was primarily due to competitive market conditions, particularly in the Asia-Pacific Region.

Selling, General and Administrative Expenses. Selling, general and administrative expenses decreased $38.1 million from $90.3 million to $52.2 million. This decrease was principally due to a reduction in bad debt expense of $28.0 million from $29.9 million to $1.9 million in 2001. The bad debt expense in 2000 was primarily from certain U.S.-based accounts receivable, the collectibility of which had deteriorated significantly in

the second quarter of 2000 and which were further affected by the Company's decision to sell its majority interest in its joint venture in Brazil and the phase out of a major portion of the

redistributor business in its Miami and North America operations. Bad debt expense in 2001, includes a recovery of $3.9 million related to a receivable from a satellite handset customer which was reserved in the fourth quarter of 2000. Selling, general and administrative expenses related to the Brazil and Venezuela operations, which were sold in August 2000 and December 2000, respectively, were $0.2 million in 2001 and $10.0 million in 2000.

Restructuring Charge (Credit). In connection with its previously announced intent, the Company restructured its Miami facilities in the second quarter of 2001 to reduce the size and cost of those operations, resulting in a charge of $0.8 million, primarily related to the impairment of leasehold improvements.

Equity in Loss of Affiliated Companies. Equity in loss of affiliated companies increased from $0.4 million to $0.7 million in 2001 due to losses from the Company's 49% minority interest in CellStar Amtel. As a result of the continuing deterioration in the Malaysia market, the Company intends to divest its ownership in CellStar Amtel to limit further exposure. The Company will be required to recognize future losses, if any, of CellStar Amtel up to the amount of debt and payables of CellStar Amtel guaranteed by the Company. The Company currently estimates the remaining exposure to be up to $1.0 million.

Gain on Sale of Assets. The Company recorded a gain on sale of assets of $0.9 million in 2001 primarily associated with the sale of its Venezuela operations in December 2000.

Interest Expense. Interest expense increased to $9.0 million from $8.8 million.

Other, Net. Other, net increased $3.2 million, from income of $0.4 million to income of $3.6 million, primarily due to gains on foreign currencies related to European operations in 2001 compared with losses in 2000 and increased interest income.

Income Taxes. Income tax expense increased from a benefit of $14.5 million in 2000 to expense of $3.9 million in 2001. The Company's annual effective tax rate decreased to 29.0% from 30.5%. The lower effective tax rate was attributable to changes in the expected geographical mix of income (loss) before income taxes.

International Operations

The Company's foreign operations are subject to various political and economic risks including, but not limited to, the following: political instability; economic instability; currency controls; currency devaluations; exchange rate fluctuations; potentially unstable channels of distribution; increased credit risks; export control laws that might limit the markets the Company can enter; inflation; changes in laws related to foreign ownership of businesses abroad; foreign tax laws; trade disputes among nations; changes in cost of capital; changes in import/export regulations, including enforcement policies, "gray market" resales, tariff and freight rates. Such risks and other factors beyond the control of the Company in any nation where the Company conducts business could have a

material adverse effect on the Company.

During the third quarter ended August 31, 2000, the Company decided, based on the current and future economic and political outlook in Venezuela, to divest its operations in Venezuela. For the quarter ended August 31, 2000, the Company recorded an impairment charge of $4.9 million to reduce the carrying value of certain Venezuela assets, primarily goodwill, to their estimated fair value. In December 2000, the Company completed the sale of its Venezuela operations and recorded a gain of $1.1 million.

The Company's sales from its Miami operations to customers exporting into South American countries continue to decline as a result of increased in-country manufactured product availability in South America, primarily Brazil. In the second quarter of 2000, the Company phased out a major portion of its redistributor business in Miami. In connection with its previously announced intent, the Company restructured its Miami facilities in the second quarter of 2001 to reduce the size and cost of those operations, resulting in a charge of $0.8 million, primarily related to the impairment of leasehold improvements.

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As a result of the continuing deterioration in the Malaysia market, the Company intends to limit further exposure by divesting its 49% ownership in CellStar Amtel. The carrying value of the investment at May 31, 2001 was $35,000. During the quarter ended February 28, 2001, the Company incurred a $0.7 million loss related to the operations of CellStar Amtel. No additional losses were incurred in the quarter ended May 31, 2001. The Company will be required to recognize future losses, if any, of CellStar Amtel up to the amount of debt and payables of CellStar Amtel guaranteed by the Company. The Company currently estimates the remaining exposure to be up to $1.0 million.

In April 2000, the Company curtailed a significant portion of its U.K. international trading operations following third party theft and fraud losses. The trading business involves the purchase of products from suppliers other than manufacturers and the sale of those products to customers other than network operators or their dealers and other representatives.

Liquidity and Capital Resources

During the six months ended May 31, 2001, the Company relied primarily on cash available at November 30, 2000, funds generated from operations and borrowings under its Multicurrency Revolving Credit Facility (the "Facility") to fund working capital, capital expenditures and expansions. At May 31, 2001, the Company had borrowed $16.1 million under the Facility.

As of January 30, 2001, the Company had negotiated an amendment to its Facility that reduced the amount of the Facility from $100.0 million to $86.4 million.

On February 27, 2001, the Company and its banking syndicate negotiated and executed a Second Amended and Restated Credit Agreement that further reduced the amount of the Facility to $85.0 million on February 27, 2001, $74.0 million on July 31, 2001, $65.0 million on September 30, 2001, and $50.0 million on December 15, 2001. Such Second Amended and Restated Credit Agreement further (i) increases the applicable interest rate margin by 25 basis points, (ii) shortens the term of the

Facility from June 1, 2002 to March 1, 2002, (iii) provides additional collateral for such Facility in the form of additional stock pledges and mortgages on real property, (iv) provides for dominion of funds by the banks for the Company's U.S. operations, (v) limits the borrowing base, and (vi) tightens restrictions on the Company's ability to fund its operations, particularly its non-U.S. operations.

As of July 3, 2001, the Company had negotiated an additional amendment to the Facility that reduced the borrowing capacity under the Facility from $85.0 million to $40.0 million and waived compliance with a covenant for the quarter ended May 31, 2001.

At July 9, 2001 the Company had available $29.5 million of unused borrowing capacity under the Facility.

At May 31, 2001, the Company's operations in the PRC had three lines of credit, one for USD $12.5 million, the second for RMB 215 million (approximately USD $26.0 million) and the third for RMB 50 million (approximately USD $6.0 million), bearing interest at 7.16%, 5.85% and 2.34% respectively. The loans have maturity dates through August 2001. The first two lines of credit are fully collateralized by U.S. dollar cash deposits. The cash deposit was made via an intercompany loan from the operating entity in Hong Kong as a mechanism to secure repatriation of these funds. The third line of credit is supported by a RMB 15.0 million cash collateral deposit and a promissory note. At May 31, 2001, the U.S. dollar equivalent of $30.8 million had been borrowed against the lines of credit in the PRC. As a result of this method of funding operations in the PRC, the consolidated balance sheet at May 31, 2001 reflects USD $41.3 million in cash that is restricted as collateral on these advances and a corresponding USD $30.8 million in notes payable. The Company anticipates renewing these loans in the normal course of business.

In addition, the Company has notes payable in Taiwan and Peru totaling $10.9 million.

Cash, cash equivalents, and restricted cash as of May 31, 2001 were $85.5 million, compared to $119.6 million at November 30 2000, primarily reflecting the use of the cash to reduce the Facility.

Compared to November 30, 2000, accounts receivable decreased from $346.0 million to $218.8 million at May 31, 2001. Inventories declined to $165.9 million at May 31, 2001, from $265.6 million at November 30, 2000. Management has worked aggressively to reduce accounts receivable and inventory levels through tightening of credit policies, aggressive collection efforts, and better purchasing and inventory management. Accounts payable declined to $161.0 million at May 31, 2001, compared to $361.0 million at November 30, 2000.

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Based upon current and anticipated levels of operations, and aggressive efforts to reduce inventories and accounts receivable, the Company anticipates that its cash flow from operations, together with amounts available under its Facility and existing unrestricted cash balances, will be adequate to meet its anticipated cash requirements in the foreseeable future. In the event that existing unrestricted cash balances, cash flows and available borrowings under the Facility are not sufficient to meet future cash requirements, the Company may be required to reduce planned expenditures or seek additional financing. The Company is evaluating alternatives with respect to the maturity of its Facility in March 2002 and its $150.0 million in long-term debt that matures in

October 2002. The Company can provide no assurances that reductions in planned expenditures would be sufficient to cover shortfalls in available cash or that additional or alternative financing would be available or, if available, offered on terms acceptable to the Company.

Accounting Pronouncement Not Yet Adopted

In December 1999, the SEC staff issued Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements" ("SAB 101"). SAB 101 summarizes certain of the staff's views in applying generally accepted accounting principles to revenue recognition and accounting for deferred costs in the financial statements and is effective no later than the fourth quarter of fiscal years beginning after December 15, 1999. Based on the Company's current revenue recognition policies, SAB 101 is not expected to materially impact the Company's financial position and consolidated results of operations.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Foreign Exchange Risk

For the quarters ended May 31, 2001 and 2000, the Company recorded in other income (expense), net foreign currency gains and (losses) of $20,000 and ($1.2) million, respectively. The losses in 2000 were primarily due to the revaluations of foreign currency related to the Company's European operations.

Regarding the intercompany advances from the Hong Kong entity to the PRC entity, the Company has foreign exchange exposure on the funds as they have been effectively converted into RMB.

The Company manages foreign currency risk by attempting to increase prices of products sold at or above the anticipated exchange rate of the local currency relative to the U.S. dollar, by indexing certain of its accounts receivable to exchange rates in effect at the time of their payment and by entering into foreign currency hedging instruments in certain instances. The Company consolidates the bulk of its foreign exchange exposure related to intercompany transactions in its international finance subsidiary. These transactional exposures are managed using various derivative alternatives depending on the length and size of the exposure. The Company continues to evaluate foreign currency exposures and related protection measures.

Derivative Financial Instruments

The Company uses various derivative financial instruments as part of an overall strategy to manage the Company's exposure to market risk associated with interest rate and foreign currency exchange rate fluctuations. The Company periodically uses foreign currency forward contracts to manage the foreign currency exchange rate risks associated with international operations. The Company evaluates the use of interest rate swaps and cap agreements to manage its interest risk on debt instruments, including the reset of interest rates on variable rate debt. The Company does not hold or issue derivative financial instruments for trading purposes.

The risk of loss to the Company in the event of non-performance by any counterparty under derivative financial instrument agreements is not significant. Although the derivative financial instruments expose the

Company to market risk, fluctuations in the value of the derivatives are mitigated by expected offsetting fluctuations in the matched instruments.

The Company uses foreign currency forward contracts to reduce exposure to exchange rate risks primarily associated with transactions in the regular course of the Company's international operations. The forward contracts establish the exchange rates at which the Company purchases or sells the contracted amount of local currencies for specified foreign currencies at a future date. The Company uses forward contracts, which are short-term in nature (45 days to one year), and receives or pays the difference between the contracted forward rate and the exchange rate at the settlement date.

At May 31, 2001, the Company had French franc forward contracts with a contractual amount of $5.6 million. The carrying amount and fair value of theses contracts are not significant. These derivatives are not accounted for as hedges under Statement 133.

Interest Rate Risk

The interest rate of the Company's Facility is an index rate at the time of borrowing plus an applicable margin on certain borrowings. The interest rate is based on either the agent bank's prime lending rate or the London Interbank Offered Rate. Additionally, the applicable margin is subject to increases as the Company's ratio of consolidated funded debt to consolidated cash flow increases. During the quarter ended May 31, 2001, the interest rates of borrowings under the Facility ranged from 7.3% to 10.0%. A one percent change in variable interest rates will not have a material impact on the Company. The Company manages its borrowings under the Facility each business day to minimize interest expenses.

The Company has short-terms borrowings in the PRC as discussed in Liquidity and Capital Resources. The note payable in Taiwan bears interest at 5.85% and the note payable in Peru does not bear interest.

The Company's $150.0 million in long-term debt has a fixed coupon interest rate of 5.0% and is due in October 2002.

Part II - OTHER INFORMATION

Item 1. Legal Proceedings

During the period from May 1999 through July 1999, seven purported class action lawsuits were filed in the United States District Court for the Southern District of Florida, Miami Division, styled as follows: (1) Elfie Echavarri v. CellStar Corporation, Alan H. Goldfield, Richard M. Gozia and Mark Q. Huggins; (2) Mark Krug v. CellStar Corporation, , Alan H. Goldfield, Richard M. Gozia and Mark Q. Huggins; (3) Jewell Wright v. CellStar Corporation, , Alan H. Goldfield, Richard M. Gozia and Mark Q. Huggins; (4) Theodore Weiss v. CellStar Corporation, , Alan H. Goldfield, Richard M. Gozia and Mark Q. Huggins; (5) Tony LaBella v. CellStar Corporation, , Alan H. Goldfield, Richard M. Gozia and Mark Q. Huggins; (6) Thomas F. Petrone v. CellStar Corporation, , Alan H. Goldfield, Richard M. Gozia and Mark Q. Huggins; and (7) Adele Brody v. CellStar Corporation, , Alan H. Goldfield, Richard M. Gozia and Mark Q. Huggins. Each of the above lawsuits sought certification as a class action to represent those persons who purchased the publicly traded securities of the Company during the period from March 19, 1998, to September 21, 1998. Each of these lawsuits alleges that the Company issued a series of materially false and misleading statements concerning the Company's results of operations and investment in Topp Telecom, Inc. ("Topp"), resulting in violations of Section 10(b) and 20(a) of the Securities Exchange Act of 1934, as amended (the "Exchange

Act"), and Rule 10b-5 promulgated thereunder.

The Court entered an order on September 26, 1999 consolidating the above lawsuits and appointing lead plaintiffs and lead plaintiffs' counsel. On November 8, 1999, the lead plaintiffs filed a consolidated complaint. The Company filed a Motion to Dismiss the consolidated complaint and the Court granted that motion on August 3, 2000. The plaintiffs filed a Second Amended and Consolidated Complaint on September 1, 2000, essentially re-alleging the violations of Sections 10(b) and 20(a) of the

Exchange Act, and Rule 10b-5 promulgated thereunder. The Company filed a Motion to Dismiss plaintiffs' Second Amended and Consolidated Complaint on November 2, 2000, but the Court has not yet rendered a decision. The Company believes that is has fully complied with all applicable securities laws and regulations and that it has meritorious defenses to the allegations made in the Second Amended and Consolidated Complaint. The Company intends to vigorously defend the consolidated action if its Motion to Dismiss is denied.

On August 3, 1998, the Company announced that the Securities and Exchange Commission (SEC) was conducting an investigation of the Company relating to its compliance with federal securities laws. On June 28, 2001, the Company announced that the SEC has terminated the investigation with no enforcement action recommended.

The Company is a party to various other claims, legal actions and complaints arising in the ordinary course of business.

Management believes that the disposition of these matters will not have a materially adverse effect on the consolidated financial condition or results of operations of the Company.

Item 6. Exhibits and Reports on Form 8-K

(A) Exhibits.

3.1 Amended and Restated Certificate of Incorporation of CellStar Corporation ("Certificate of Incorporation"). (1)

3.2 Certificate of Amendment to Certificate of Incorporation. (7)

3.3 Amended and Restated Bylaws of CellStar Corporation. (8)

4.1 The Certificate of Incorporation, Certificate of Amendment to Certificate of Incorporation and Amended and Restated Bylaws of CellStar Corporation filed as Exhibits 3.1, 3.2, and 3.3 are incorporated into this item by reference. (1)(7)(8)

4.2 Specimen Common Stock Certificate of CellStar Corporation. (2)

4.3 Rights Agreement, dated as of December 30, 1996, by and between CellStar Corporation and ChaseMellon Shareholder Services, L.L.C., as Rights Agent ("Rights Agreement"). (4)

4.4 First Amendment to Rights Agreement, dated as of June 18, 1997. (5)

4.5 Form of Certificate of Designation, Preference and Rights of Series A Preferred Stock of CellStar Corporation ("Certificate of Designation"). (4)

4.6	Form of Rights Certificate. (4)
4.7	Certificate of Correction of Certificate of Designation. (5)
4.8	Indenture, dated as of October 14, 1997, by and between CellStar Corporation and the Bank of New York, as Trustee. (6)
10.1	Second Amendment to Second Amended and Restated Credit Agreement, dated as of July 3, 2001, by and among CellStar Corporation, the Financial Institutions Signatory Thereto, and The Chase Manhattan Bank, as Agent for such Financial Institutions. (8)
10.2	Separation Agreement and Release, dated as of July 5, 2001, by and among CellStar Corporation and Alan H. Goldfield. (8)(9)
10.3	Consulting Agreement, dated as of July 5, 2001, by and among CellStar Corporation and Alan H. Goldfield. (8)(9)
10.4	Employment Agreement, dated as of July 5, 2001, by and among CellStar Corporation and Terry S. Parker. (8)(9)

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(1) Previously filed as an exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended August 31, 1995, and incorporated herein by reference.

(2) Previously filed as an exhibit to the Company's Annual Report on Form 10-K for the fiscal year ended November 30, 1995, and incorporated herein by reference.

(3) Previously filed as an exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended February 29, 1996, and incorporated herein by reference.

(4) Previously filed as an exhibit to the Company's Registration Statement on Form 8 - A (File No. 000-22972), filed January 3, 1997, and incorporated herein by reference.

(5) Previously filed as an exhibit to the Company's Registration Statement on Form 8-A/A, Amendment No.1 (File No. 000-22972), filed June 30, 1997, and incorporated herein by reference.

(6) Previously filed as an exhibit to the Company's Current Report on Form 8-K dated October 8, 1997, filed October 24, 1997, and incorporated herein by reference.

(7) Previously filed as an exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended May 31, 1998, and incorporated herein by reference.

(8) Filed herewith.

(9) The exhibit is a management contract or compensatory plan or arrangement.

(B) Reports on Form 8-K

1. Form 8-K dated June 28, 2001 and filed on June 28, 2001 pursuant to Items 5 and 7.

Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CELLSTAR CORPORATION

/s/ AUSTIN P. YOUNG

By: Austin P. Young
Senior Vice President, Chief Financial Officer and Treasurer
(Principal Financial Officer)

/s/ RAYMOND L. DURHAM

By: Raymond L. Durham
Vice President, Corporate Controller
(Principal Accounting Officer)

Date: July 11, 2001

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