TWEETER HOME ENTERTAINMENT GROUP INC
Form 10-Q
May 15, 2002

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# Form 10-Q

**SECURITIES AND EXCHANGE COMMISSION**
**WASHINGTON, D.C. 20549**

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

**For the quarterly period ended March 31, 2002**

**Commission file number: 0-24091**

# Tweeter Home Entertainment Group, Inc.

*(Exact name of Registrant as specified in its charter)*

| | |
|---|---|
| **DELAWARE** | **04-3417513** |
| *(State or other jurisdiction of incorporation or organization)* | *(I.R.S. Employer Identification No.)* |

**40 PEQUOT WAY**
**CANTON, MA 02021**
*(Address of principal executive offices including zip code)*

**781-830-3000**
*(Registrant s telephone number including area code)*

Indicate by check mark whether the registrant (1) has filed all reports required 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 [ ]

Indicate the number of shares outstanding of each of the registrant s classes of common stock, as of the latest practicable date.

| TITLE OF CLASS | OUTSTANDING AT MAY 10, 2002 |
|---|---|
| Common Stock, $.01 par value | 23,446,283 |

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**TWEETER HOME ENTERTAINMENT GROUP, INC. AND SUBSIDIARIES**

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**TWEETER HOME ENTERTAINMENT GROUP, INC. AND SUBSIDIARIES**
**CONSOLIDATED BALANCE SHEETS**

| | September 30, 2001 | March 31, 2002 |
|---|---|---|
| | | (Unaudited) |
| **ASSETS** | | |
| **CURRENT ASSETS:** | | |
| Cash and cash equivalents | $ 3,277,969 | $ 3,012,343 |
| Accounts receivable, net of allowance for doubtful accounts of at September 30, 2001 and $958,000 at March 31, 2002 | 31,251,444 | 33,573,367 |
| Inventory | 129,172,638 | 155,215,829 |
| Deferred tax assets | 4,054,489 | 4,686,819 |
| Prepaid expenses and other current assets | 3,468,864 | 3,620,491 |
| Total current assets | 171,225,404 | 200,108,849 |
| Property and equipment, net | 109,141,981 | 130,798,357 |
| Investment in joint venture | 3,397,722 | 2,412,956 |
| Long-term investments | 1,194,425 | 1,132,245 |
| Intangible assets, net | 7,254,832 | 6,813,948 |
| Other assets, net | 536,675 | 1,995,171 |
| Goodwill, net | 187,676,605 | 191,445,340 |
| **TOTAL** | $480,427,644 | $534,706,866 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | |
| **CURRENT LIABILITIES:** | | |
| Current portion of long-term debt | $ 322,245 | $ 288,958 |
| Amount due to bank | 8,464,682 | 31,822,325 |
| Accounts payable | 38,557,984 | 25,734,720 |
| Accrued expenses | 38,887,498 | 37,384,214 |
| Customer deposits | 13,998,996 | 15,747,878 |
| Deferred warranty | 532,681 | 497,563 |
| Total current liabilities | 100,764,086 | 111,475,658 |
| **LONG-TERM DEBT** | 36,699,411 | 61,407,256 |
| **OTHER LONG-TERM LIABILITIES:** | | |
| Rent related accruals | 9,326,705 | 9,368,301 |
| Deferred warranty | 1,048,562 | 609,144 |
| Deferred tax liabilities | 197,353 | 263,806 |
| Total other long-term liabilities | 10,572,620 | 10,241,251 |
| Total liabilities | 148,036,117 | 183,124,165 |
| **STOCKHOLDERS EQUITY** | | |
| Preferred stock, $.01 par value, 10,000,000 shares authorized, no shares issued | | |
| Common stock, $.01 par value, 60,000,000 shares authorized; 24,722,974 shares issued at September 30, 2001 and 25,273,685 at March 31, 2002 | 247,230 | 252,737 |
| Additional paid in capital | 285,132,941 | 288,216,684 |

| | | |
|---|---|---|
| Accumulated other comprehensive income | 65,918 | 66,721 |
| Retained earnings | 48,823,695 | 64,918,750 |
| Total | 334,269,784 | 353,454,892 |
| Less treasury stock: 1,856,146 shares at September 30, 2001 and 1,847,480 shares at March 31, 2002, at cost | (1,878,257) | (1,872,191) |
| Total stockholders equity | 332,391,527 | 351,582,701 |
| **TOTAL** | $480,427,644 | $534,706,866 |

See notes to unaudited consolidated financial statements.

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**TWEETER HOME ENTERTAINMENT GROUP, INC. AND SUBSIDIARIES**
**CONSOLIDATED STATEMENTS OF INCOME**
**(Unaudited)**

| | Three Months Ended March 31, | | Six Months Ended March 31, | |
|---|---|---|---|---|
| | **2001** | **2002** | **2001** | **2002** |
| Total revenue | $117,832,704 | $ 185,822,422 | $ 279,801,085 | $ 437,735,369 |
| Cost of sales | (75,045,629) | (119,459,995) | (178,900,194) | (279,470,570) |
| Gross Profit | 42,787,075 | 66,362,427 | 100,900,891 | 158,264,799 |
| Selling expenses | 30,492,228 | 51,177,133 | 66,541,431 | 109,661,596 |
| Corporate, general and administrative expenses | 6,094,651 | 9,895,046 | 12,155,989 | 19,905,451 |
| Amortization of intangibles | 480,000 | 415,635 | 960,000 | 790,885 |
| Income from operations | 5,720,196 | 4,874,613 | 21,243,471 | 27,906,867 |
| Income from joint venture | 198,973 | | 684,180 | 71,952 |
| Interest income (expense), net | 380,163 | (551,045) | 701,671 | (1,149,838) |
| Income before income taxes | 6,299,332 | 4,323,568 | 22,629,322 | 26,828,981 |
| Income taxes | 2,515,781 | 1,731,760 | 9,047,777 | 10,733,926 |
| NET INCOME | $ 3,783,551 | $ 2,591,808 | $ 13,581,545 | $ 16,095,055 |
| Basic earnings per share | $ 0.20 | $ 0.11 | $ 0.73 | $ 0.69 |
| Diluted earnings per share | $ 0.20 | $ 0.11 | $ 0.71 | $ 0.66 |
| Weighted average shares outstanding: | | | | |
| Basic | 18,630,582 | 23,364,781 | 18,555,020 | 23,190,794 |
| Diluted | 19,132,049 | 24,371,799 | 19,191,483 | 24,341,117 |

See notes to unaudited consolidated financial statements.

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**TWEETER HOME ENTERTAINMENT GROUP, INC. AND SUBSIDIARIES**
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

| | Six Months Ended March 31, | |
|---|---|---|
| | 2001 | 2002 |
| **CASH FLOWS FROM OPERATING ACTIVITIES:** | | |
| Net income | $ 13,581,545 | $ 16,095,055 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 4,945,628 | 8,523,327 |
| Income from joint venture | (684,180) | (71,952) |
| Gain on disposal of equipment | (5,000) | (6,950) |
| Provision for uncollectible accounts | 45,000 | 334,071 |
| Deferred income tax provision | (348,092) | (566,413) |
| Changes in operating assets and liabilities, net of effects from acquisition of business: | | |
| Increase in accounts receivable | (1,873,281) | (2,395,262) |
| (Increase) decrease in inventory | 9,861,962 | (24,126,513) |
| Increase in prepaid expenses and other assets | (246,804) | (1,608,446) |
| Decrease in accounts payable and accrued expenses | (10,255,728) | (15,788,859) |
| Increase in customer deposits | 28,747 | 1,240,914 |
| Increase (decrease) in deferred rent | 628,685 | 41,596 |
| Decrease in deferred warranty | (217,266) | (474,536) |
| Net cash provided (used) by operating activities | 15,461,216 | (18,803,968) |
| **CASH FLOWS FROM INVESTING ACTIVITIES:** | | |
| Purchase of property and equipment | (11,502,921) | (28,893,692) |
| Proceeds from sale of property and equipment | 5,000 | 6,950 |
| (Purchase) sale of investments | (2,774,459) | 63,519 |
| Cash paid for acquisitions | (4,828,359) | (3,799,969) |
| Distributions from joint venture | | 1,033,175 |
| Net cash used in investing activities | (19,100,739) | (31,590,017) |
| **CASH FLOWS FROM FINANCING ACTIVITIES:** | | |
| Increase (decrease) in amount due to bank | (5,063,328) | 23,357,643 |
| Net proceeds (payments) of long term debt | (6,157) | 24,674,558 |
| Equity transactions | 699,159 | 2,096,158 |
| Net cash provided (used) by financing activities | (4,370,326) | 50,128,359 |
| **DECREASE IN CASH AND CASH EQUIVALENTS** | (8,009,849) | (265,626) |
| **CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD** | 34,292,555 | 3,277,969 |
| **CASH AND CASH EQUIVALENTS, END OF PERIOD** | $ 26,282,706 | $ 3,012,343 |
| **SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:** | | |
| Cash paid during the period for: | | |
| Interest | $ 8,048 | $ 1,144,549 |

| | | |
|---|---|---|
| Taxes | $ 7,958,500 | $ 6,602,777 |
| Noncash investing activities: | | |
| Issuance of common stock for acquisitions | $ 1,329,880 | $ 1,000,016 |

See notes to unaudited consolidated financial statements.

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**TWEETER HOME ENTERTAINMENT GROUP, INC. AND SUBSIDIARIES**
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

### 1. Basis of Presentation

The unaudited condensed consolidated financial statements of Tweeter Home Entertainment Group, Inc. and its subsidiaries ( Tweeter or the Company ), included herein, should be read in conjunction with the consolidated financial statements and notes thereto included in Tweeter s Annual Report on Form 10-K for the fiscal year ended September 30, 2001.

### 2. Accounting Policies

The unaudited consolidated financial statements of Tweeter have been prepared in accordance with accounting principles generally accepted in the United States of America. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation of the interim consolidated financial statements have been included. Operating results for the six-month period ended March 31, 2002 are not necessarily indicative of the results that may be expected for the fiscal year ending September 30, 2002. Tweeter typically records its highest revenue and earnings in its first fiscal quarter.

### 3. Earnings per Share

The weighted average shares used in computing basic and diluted net income per share are presented in the table below. Certain options are not included in the earnings per share calculation when the exercise price is greater than the average market price for the period. The number of options excluded in each period is reflected in the table.

| | Three Months Ended March 31, | | Six Months Ended March 31, | |
|---|---|---|---|---|
| | 2001 | 2002 | 2001 | 2002 |
| **Basic Earnings Per Share:** | | | | |
| Numerator: | | | | |
| Net income | $ 3,783,551 | $ 2,591,808 | $13,581,545 | $16,095,055 |
| Denominator: | | | | |
| Weighted average common shares outstanding | 18,630,582 | 23,364,781 | 18,555,020 | 23,190,794 |
| **Basic earnings per share** | $ 0.20 | $ 0.11 | $ 0.73 | $ 0.69 |
| Diluted Earnings Per Share: | | | | |
| Numerator: | $ 3,783,551 | $ 2,591,808 | $13,581,545 | $16,095,055 |
| Denominator: | | | | |
| Weighted average shares outstanding | 18,630,582 | 23,364,781 | 18,555,020 | 23,190,794 |
| Potential common stock outstanding | 501,467 | 1,007,018 | 636,463 | 1,150,323 |
| Total | 19,132,049 | 24,371,799 | 19,191,483 | 24,341,117 |
| Diluted earnings per share | $ 0.20 | $ 0.11 | $ 0.71 | $ 0.66 |
| Anti dilutive options not included in Earnings per share calculation | 452,050 | 136,500 | 447,198 | 502,600 |
| Price Range | $18.688 to $32.125 | $25.04 to $32.125 | $21.00 to $32.125 | $23.125 to $32.125 |

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**4. Comprehensive Income**

Comprehensive income for the three and six months ended March 31, 2001 and March 31, 2002 was as follows:

| | Three Months Ended March 31, | | Six Months Ended March 31, | |
|---|---|---|---|---|
| | 2001 | 2002 | 2001 | 2002 |
| Net income | $3,783,551 | $2,591,808 | $13,581,545 | $16,095,055 |
| Change in fair value of long-term investments (net of tax) | (429,840) | (5,387) | (44,309) | 803 |
| Comprehensive income | $4,213,391 | $2,586,421 | $13,537,236 | $16,095,858 |

**5. Tweeter@Outpost.com Joint Venture**

On February 9, 2002, the Company s joint venture with Cyberian Outpost, Inc. was dissolved. The Company discontinued its Internet operations on December 31, 2001. The Company believes that the carrying amount of its investment in the joint venture of approximately $2.4 million at March 31, 2002 will be realized during fiscal year 2002.

**6. Goodwill and Other Intangibles**

On October 1, 2001 the Company adopted, SFAS No.142, Goodwill and Other Intangible Assets, which eliminated the amortization of purchased goodwill and other intangibles with indefinite useful lives. SFAS No.142 changes the accounting for goodwill and intangible assets with indefinite lives from an amortization method to an impairment assessment. Other intangible assets will continue to be amortized over their useful lives. Amortization of goodwill, including goodwill recorded in prior business combinations, ceased upon the adoption of this standard. Under SFAS No.142, goodwill will be tested at least annually and more frequently if an event occurs which indicates that goodwill may be impaired. In connection with this statement, management is required to perform an impairment assessment within six months of adoption. As of March 31, 2002, the Company completed the goodwill impairment test and no impairments were indicated. The Company plans to test goodwill impairment annually during the fourth fiscal quarter.

The following financial information is presented as if the statement was adopted at the beginning of fiscal year 2001.

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| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| | March 31, 2001 | March 31, 2002 | March 31, 2001 | March 31, 2002 |
| Reported net income | $3,783,551 | $2,591,808 | $13,581,545 | $ 16,095,055 |
| Goodwill amortization | 480,000 | | 960,000 | |
| Adjusted net income | $4,263,551 | $2,591,808 | $14,541,545 | $ 16,095,055 |
| Goodwill | | | $41,255,052 | $191,445,340 |
| Basic income per share: | | | | |
| Reported net income | $ 0.20 | $ 0.11 | $ 0.73 | $ 0.69 |
| Goodwill amortization | $ 0.03 | | 0.05 | |
| Adjusted net income | $ 0.23 | $ 0.11 | $ 0.78 | $ 0.69 |
| Diluted income per share: | | | | |
| Reported net income | $ 0.20 | $ 0.11 | $ 0.71 | $ 0.66 |
| Goodwill amortization | $ 0.03 | | 0.05 | |
| Adjusted net income | $ 0.23 | $ 0.11 | $ 0.76 | $ 0.66 |

The financial information for acquired intangible assets is as follows:

| | September 30, 2001 | March 31, 2002 |
|---|---|---|
| Non compete Agreements | | |
| Original Cost | $3,905,000 | $4,255,000 |
| Accumulated Amortization | 130,168 | 561,052 |
| Tradenames: | | |
| Original Cost | $3,600,000 | $3,600,000 |
| Accumulated Amortization | 120,000 | 480,000 |

For the three and six months ended March 31, 2002, the aggregate amortization expense was $415,632 and $790,885, respectively. For each of the fiscal years 2002 through 2005, the amortization expense is estimated to be approximately $1.5 million and for fiscal year 2006, amortization expense is estimated to be approximately $1.25 million.

**7. Hillcrest High Fidelity Acquisition**

On March 1, 2002, Tweeter completed the acquisition of Hillcrest High Fidelity, Inc. ( Hillcrest ), located in the greater Dallas, Texas market. Hillcrest is a two-store specialty retailer that has operated in Dallas for 53 years, with annual revenues of approximately $14 million. This transaction was accounted for as a purchase. Tweeter paid in $4.4 million cash, and issued 42,886 shares of its common stock from its shelf registration filed on April 13, 1999 with the Securities and Exchange Commission, and amended on December 23, 1999, in consideration for the acquisition. The results of operations for the acquired entity for the one-month ended March 31, 2002 would not have been significant to the consolidated operations of Tweeter. Accordingly, pro forma information has not been presented. The allocation of the purchase price, which is preliminary, resulted in goodwill to date of approximately $4,118,000. The approximate net assets assumed at fair market value on March 1, 2002 were allocated as follows:

| | |
|---|---|
| Inventory | $ 1,917,000 |
| Property and equipment | 434,000 |
| Accounts receivable/Prepaids/Other | 440,000 |
| Other current liabilities | (1,370,000) |
| Net assets acquired | 1,421,000 |
| Total purchase price and related costs (including the issuance of 42,886 shares if common stock with a fair market value of $1,000,000) | 5,539,000 |
| Goodwill | $ 4,118,000 |

**8. Subsequent Events**

On May 7, 2002, Tweeter announced that is had formed a relationship with Global Sports Inc. (Nasdaq: GSPT) to operate the www.tweeter.com e-commerce site. Under the agreement, Tweeter will be responsible for directing the user experience of the new www.tweeter.com e-commerce site. Tweeter will handle all of the merchandising, branding and designing of the look and feel of the Web site. Global Sports will be responsible for the technology, customer service, order processing, and fulfillment for which they will be paid a fee. The new online store will feature a selection of mid-to-high end audio video technology for the home and car and is expected to launch later this fall.

**9. Reclassifications**

Certain 2001 reclassifications have been made to conform to the 2002 presentation.

**10. New Accounting Pronouncements**

In August 2001, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards ( SFAS ) No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, which addresses financial accounting and reporting for the impairment or disposal of long-lived assets. SFAS No. 144 supersedes SFAS No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of, and the accounting and reporting provisions of Accounting Principles Board ( APB ) Opinion No. 30, Reporting the Results of Operations Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions. The provisions of SFAS No. 144 are effective for financial statements issued for fiscal years beginning after December 15, 2001, and interim periods within those fiscal years. The Company is in the process of evaluating the impact that implementing SFAS No. 144 will have on its consolidated financial statements.

**ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**INTRODUCTION**

Tweeter is a specialty retailer of mid to high-end audio and video consumer electronics products. Tweeter currently operates 158 stores under the Tweeter, HiFi Buys, Sound Advice, Bang & Olufsen, Electronic Interiors, Showcase Home Entertainment and Hillcrest names in the New England, Texas, San Diego, Mid-Atlantic, Chicago, Southeast, Florida and Phoenix markets.

**RESULTS OF OPERATIONS**

**THREE MONTHS ENDED MARCH 31, 2002 AS COMPARED TO THREE MONTHS ENDED MARCH 31, 2001**

*Total Revenue.* Total revenue includes delivered merchandise, labor, net commissions on service contracts sold, completed service center work orders, insurance replacement and corporate sales. Total revenue increased $68.0 million, or 57.7%, to $185.8 million for the three months ended March 31, 2002 from $117.8 million for the three months ended March 31, 2001. The increase was mainly comprised of $17.3 million from new stores and $57.1 million from acquired companies. This was offset by a comparable store sales decrease of $6.9 million. Comparable store sales were down 6.7% excluding the Company s stores acquired in the Big Screen City, Audio Video Systems, Sound Advice, Showcase and Hillcrest acquisitions. The Big Screen City stores had a comparable store sales decrease of 23.9%, the Audio Video Systems stores had a comparable store sales increase of 7.3%, the Sound Advice stores had a

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comparable store sales decrease of 3.0%, the Showcase stores had a comparable store sales decrease of 27.3% and Hillcrest stores, for the month, had a comparable stores sales increase of 2.0%. Sales of HD and HD ready projection sets increased 42.8% and accounted for 94.5% of the projection television sales for the quarter. Sales of digital tubes increased by 66.2% and represented 58.4% of the category s sales for the quarter. Sales of flat panel Plasma and LCD TV s increased 167% and increased over 300% in units. Total digital sales penetration exceeded 51% of total revenue.

*Gross Profit.* Cost of sales includes merchandise costs, net delivery costs, distribution costs, home installation labor costs, purchase discounts, and vendor volume rebates. Cost of sales increased $44.4 million, or 59.2%, to $119.5 million for the three months ended March 31, 2002 from $75.0 million for the three months ended March 31, 2001. Gross profit increased $23.6 million, or 55.1%, to $66.4 million for the three months ended March 31, 2002 from $42.8 million for the three months ended March 31, 2001. The gross margin percentage decreased 60 basis points, to 35.7% for the three months ended March 31, 2002, from 36.3% for the three months ended March 31, 2001. The decrease in margin was primarily due to a reduction in purchase rebates. Purchase rebates declined 60 basis points to 350 basis points for the three months ended March 31, 2002, compared to 410 basis points for the three months ended March 31, 2001. Much of this decline is attributable to the inclusion of Sound Advice in the current period, and the Company missing certain performance targets with key suppliers resulting in the Company s inability to realize certain vendor incentives that had been realized in prior years. Pure product gross margins were flat year over year.

*Selling Expenses.* Selling expenses include the compensation of store personnel, occupancy costs, store level depreciation, advertising expenses, pre-opening expenses and credit card fees. Selling expenses increased $20.7 million, or 67.8%, to $51.2 million for the three months ended March 31, 2002 from $30.5 million for the three months ended March 31, 2001. As a percentage of revenue, selling expenses increased to 27.5% for the three months ended March 31, 2002 from 25.9% for the three months ended March 31, 2001. This was primarily driven by declines in comparable store sales and increases in fixed costs as a percentage of sales. Occupancy, depreciation and insurance expenses as a percent of revenue together increased 80 basis points for the three months ended March 31, 2002 compared to the three months ended March 31, 2001. Fringe benefits and net advertising expense increased 50 basis points for the three months ended March 31, 2002 compared to the same period in 2001.

*Corporate, General and Administrative Expenses.* Corporate, general and administrative expenses include the costs of executive officers, finance, merchandising, marketing, information systems, human resources, training, and related support functions. Corporate, general and administrative expenses increased 62.3% to $9.9 million for the three months ended March 31, 2002 from $6.1 million for the three months ended March 31, 2001. As a percentage of total revenue, corporate general and administrative expenses increased to 5.3% for the three months ended March 31, 2002 from 5.2% for the three months ended March 31, 2001. This increase was primarily due to increases in depreciation, travel costs and provision for uncollectible accounts.

*Amortization of Intangibles.* Amortization of intangibles decreased to $416,000 for the three months ended March 31, 2002 from $480,000 for the three months ended March 31, 2001. The decrease was due to the October 1, 2001 adoption of Financial Accounting Standards Board ( FASB ) Statement of Financial Accounting Standards ( SFAS ) No. 142, Goodwill and Other Intangible Assets. This statement requires that amortization be recorded only on intangible assets with definitive lives and not on goodwill or indefinite lived intangibles.

*Net Interest Income (Expense).* Net interest expense increased to $551,000 for the three months ended March 31, 2002 from net interest income of $380,000 for the three months ended March 31, 2001. This increase is due primarily to the borrowings on our revolving credit agreement during the three months ended March 31, 2002 compared to cash investment income realized on our outstanding cash balances during the three months ended March 31, 2001. The increase in borrowings was due to the debt acquired in the Sound Advice acquisition, the opening of new stores and the higher than anticipated inventory levels during the quarter.

*Income Taxes.* The effective tax rate for the fiscal quarters ended March 31, 2002 and March 31, 2001 was 40.0%.

*Seasonality.* Tweeter s operations, in common with other retailers, are subject to seasonal influences. Historically, Tweeter has realized more of its revenue and net earnings in its first fiscal quarter, which includes the holiday season, than in any other fiscal quarter. The net earnings of any interim quarter are seasonally disproportionate to net sales since certain selling expenses and administrative expenses are relatively fixed during the year. Therefore, interim results should not be relied upon as necessarily indicative of results for the entire fiscal year.

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**SIX MONTHS ENDED MARCH 31, 2002 AS COMPARED TO SIX MONTHS ENDED MARCH 31, 2001**

*Total Revenue.* Total revenue increased $157.9 million, or 56.4%, to $437.7 million for the six months ended March 31, 2002 from $279.8 million for the six months ended March 31, 2001. The increase was mainly comprised of $39.1 million from new stores and $128.4 million derived by sales from the acquisitions of Big Screen City, Audio Video Systems, Sound Advice/Showcase and Hillcrest. This was offset by a comparable store sales decrease of $9.2 million. Comparable store sales, excluding acquired stores, decreased by 3.7%. Digital technology products continue to drive sales performance as it represented over 52% of revenues for the six months ended March 31, 2002.

*Gross Profit.* Cost of sales increased $100.6 million, or 56.2% to $279.5 million for the six months ended March 31, 2002 from $178.9 million for the six months ended March 31, 2001. Gross profit increased $57.4 million, or 56.9% to $158.3 million for the six months ended March 31, 2002 from $100.9 million for the six months ended March 31, 2001. The gross margin percentage increased 10 basis points to 36.2% from 36.1% last year.

*Selling Expenses.* Selling expenses increased $43.1 million, or 64.8%, to $109.7 million for the six months ended March 31, 2002 from $66.5 million for the six months ended March 31, 2001. As a percentage of revenue, selling expenses increased to 25.1% for the six months ended March 31, 2002 from 23.8% in the prior year period. This increase was primarily due to higher occupancy costs, net advertising expense, banking fees associated with the extended credit card financing and higher insurance costs.

*Corporate, General and Administrative Expenses.* Corporate, general and administrative expenses for the six months ended March 31, 2002 increased 63.7% to $19.9 million from $12.2 million for the six months ended March 31, 2001. As a percentage of total revenue, corporate general and administrative expenses increased to 4.5% for the six months ended March 31, 2002 from 4.3% for the prior year period. This increase was due to higher depreciation expense, payroll costs, travel costs and provision for uncollectible accounts.

*Amortization of Goodwill.* Amortization of intangibles decreased to $791,000 for the six months ended March 31, 2002 from $960,000 for the six months ended March 31, 2001. The decrease was due to the adoption of FASB s SFAS No. 142, Goodwill and Other Intangible Assets. This statement requires that amortization be recorded only on intangible assets with definitive lives and not on goodwill or indefinite lived intangibles.

*Net Interest Income (Expense).* Net interest expense increased to $1.2 million for the six months ended March 31, 2002 from net interest income of $702,000 for the six months ended March 31, 2001. This increase is due primarily to the borrowings on our revolving credit agreement during the six months ended March 31, 2002 compared to cash investment income realized on our outstanding cash balances during the six months ended March 31, 2001. The increase in borrowings was due to the debt acquired in the Sound Advice, the opening of new stores and the higher than anticipated inventory levels.

*Income Taxes.* The effective tax rate for the six months ended March 31, 2002 and March 31, 2001 was 40.0%. Tweeter expects that the income tax rate for the year ending September 30, 2002 will approximate 40.0%.

**LIQUIDITY AND CAPITAL RESOURCES**

Net cash used in operating activities was $18.8 million for the six months ended March 31, 2002 compared to net cash provided of $15.5 million for the six months ended March 31, 2001. Cash used in operations for the six months ended March 31, 2002 was primarily the result of an increase in inventory of $24.1 million, a decrease in accounts payable and accrued expenses of $15.8 million and an increase in accounts receivable of $2.4 million. This was offset by net income of $16.1 million and depreciation and amortization of $8.5 million.

At March 31, 2002, working capital was $88.6 million, compared to $70.5 million at September 30, 2001. The ratio of current assets to current liabilities was 1.80 to 1 at March 31, 2002 and 1.70 to 1 at September 30, 2001.

Cash used in investing activities for the six months ended March 31, 2002 included capital expenditures of $28.9 million, primarily used for the building of new stores, the relocation of existing stores and the Hillcrest acquisition of $3.8 million.

Net cash provided by financing activities during the six months ended March 31, 2002 was $50.1 million, which was due to borrowings of long-term debt of $24.7 million and an increase in amount due to bank of $23.4 million.

Tweeter has a three-year senior credit facility, which provides the Company the ability to borrow up to $75 million. At March 31, 2002, the Company had $61,400,000 outstanding on its revolving credit facility and there was $13,600,000 available. The unpaid balances under this facility bear interest at the lender s base rate, or Eurodollar pricing plus 1.25% if the Company commits the balances for a period of thirty days or more.

On March 1, 2002, Tweeter completed the acquisition of Hillcrest High Fidelity, Inc. This transaction was accounted for as a purchase and, accordingly, the results of operations of the Company s business relating to Hillcrest are included in the consolidated statements of operations from the acquisition date. The total purchase price, including acquisition costs to date, was approximately $5.5 million, $1.0 million of which was paid through the issuance of 42,886 shares of the Company s common stock.

Tweeter believes that its existing cash, together with cash generated by operations and available borrowings under its credit facility will be sufficient to finance its working capital and capital expenditure requirements for at least the next twelve months. If management pursues additional acquisitions within this period, however, such acquisitions could strain Tweeter s capital resources. Furthermore, due to the seasonality of its business, Tweeter s working capital needs are significantly higher the fiscal third and fourth quarters and there is the possibility that this could cause unforeseen capital constraints in the future.

**New Accounting Pronouncements**

In August 2001, the FASB issued SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, which addresses financial accounting and reporting for the impairment or disposal of long-lived assets. SFAS No. 144 supersedes SFAS No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of, and the accounting and reporting provisions of Accounting Principles Board ( APB ) Opinion No. 30, Reporting the Results of Operations Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions. The provisions of SFAS No. 144 are effective for financial statements issued for fiscal years beginning after December 15, 2001, and interim periods within those fiscal years. The Company is in the process of evaluating the impact that implementing SFAS No. 144 will have on its consolidated financial statements.

**FORWARD-LOOKING STATEMENTS**

Certain statements contained in this Quarterly Report on Form 10-Q, including, without limitation, statements containing the words expects, anticipates, believes and words of similar import, constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are subject to various risks and uncertainties, including those relating to the income tax rate for fiscal 2002, Company growth and acquisitions, dependence on key personnel, the need for additional financing, competition and seasonal fluctuations, and those referred to in Tweeter s Registration Statement filed on Form S-4 on June 14, 2001, and amended on June 26, 2001, and in the Company s Annual Report on Form 10-K filed on December 21, 2001, that could cause actual future results and events to differ materially from those currently anticipated. Readers are cautioned not to place undue reliance on these forward-looking statements.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The market risk inherent in our financial instruments and in our financial position is the potential for loss arising from adverse changes in interest rates. We do not enter into financial instruments for trading purposes.

At March 31, 2002, the Company had $61,400,000 of variable rate borrowings outstanding under its revolving credit agreements, which approximates fair value. A hypothetical 10% adverse change in interest rates for this variable rate debt would have an approximate $210,000 annual impact on the Company s earnings and cash flows.

At March 31, 2002, we had approximately $111,000 in marketable equity securities. Equity market fluctuations can impact fair values (although not earnings, unless such equity positions are actually liquidated). A 10% fluctuation in the value of such securities would either reduce or increase total assets by $11,000.

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## PART II. OTHER INFORMATION

### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

On January 22, 2002, the Company held its Annual Meeting of Stockholders. At the meeting, the stockholders elected as directors Matthew Bronfman and Steven Fischman (each with 19,428,721 affirmative votes and 411,140 votes withheld). The stockholders also approved the designation of Deloitte & Touche LLP to audit the books and records of the Company for the fiscal year ending September 30, 2002 (with 19,754,332 shares voting for, 79,908 against and 5,745 abstaining).

### ITEM 5. OTHER INFORMATION

**(a) Subsequent Event**

On May 7, 2002, Tweeter announced that is had formed a relationship with Global Sports Inc. (Nasdaq: GSPT) to operate the www.tweeter.com e-commerce site. Under the agreement, Tweeter will be responsible for directing the user experience of the new www.tweeter.com e-commerce site. Tweeter will handle all of the merchandising, branding and designing of the look and feel of the Web site. Global Sports will be responsible for the technology, customer service, order processing, and fulfillment for which they will be paid a fee. The new online store will feature a selection of mid-to-high end audio video technology for the home and car and is expected to launch later this fall.

### ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

None

(b) Reports on Form 8-K.

None

## SIGNATURES

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

TWEETER HOME ENTERTAINMENT GROUP, INC.

By: /s/ Joseph McGuire
JOSEPH MCGUIRE,
Chief Financial Officer

Date: May 14, 2002

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