

TWEETER HOME ENTERTAINMENT GROUP INC

Form 10-Q

February 01, 2001

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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 December 31, 2000

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.)

**10 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  No

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

<b>TITLE OF CLASS</b>	<b>OUTSTANDING AT JANUARY 31, 2001</b>
Common Stock, \$.01 par value	18,628,819

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**Table of Contents****Tweeter Home Entertainment Group, Inc. and Subsidiaries****Condensed Consolidated Balance Sheets**

<b>September 30, 2000</b>	<b>December 31, 2000</b>
<hr/>	<hr/>

(Unaudited)

**Assets****Current Assets:** Cash and cash

equivalents \$34,292,555 \$38,686,879

Accounts receivable, net of allowance for

doubtful accounts of \$800,000 at

September 30, 2000 and \$824,000

at December 31,

2000 14,662,914 28,486,663 Inventory 85,967,261 96,995,823

Deferred

tax assets 2,424,294 2,424,294

Prepaid expenses and other current

assets 1,578,893 1,834,296

**Total current**

assets 138,925,917 168,427,955

Investment

in joint

venture 3,214,451 3,684,658

Long-term investments 1,653,109 1,062,863

Property and equipment,

net 51,937,902 56,208,504

Other

assets, net 1,262,874 933,951

Goodwill, net 38,043,290 40,743,741

**Total** \$235,037,543 \$271,061,672**Liabilities and Stockholders****Equity Current****Liabilities:** Current portion of

long-term

debt \$63,074 \$65,261

Amount due

to

bank 8,865,870 9,749,903

Accounts payable 21,499,910 22,480,447

Accrued expenses 19,509,166 37,985,025

Customer deposits 5,153,801 8,409,488

Deferred warranty 294,477 762,027

**Total current**

liabilities 55,386,298 79,452,151

**Long-Term Debt:**Notes payable  
to bank13,6382,088

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**Other Long-Term**

**Liabilities:**Rent related  
accruals3,489,6453,674,976Deferred  
warranty72,5041,362,524Deferred  
tax liabilities1,124,656808,558

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Total other long-term  
liabilities4,686,8055,846,058

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Total  
liabilities60,086,74185,300,297

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**Stockholders Equity**Preferred  
stock, \$.01 par value, 10,000,000  
shares authorized, no shares  
issued and outstanding Common  
stock, \$.01 par value, 60,000,000  
shares authorized; 20,251,734  
shares issued at September 30,  
2000 and 20,366,935 at  
December 31,  
2000202,517203,674Additional  
paid in  
capital144,538,059146,018,499Accumulated  
other comprehensive  
income176,208(297,940)Retained  
earnings31,928,91141,726,906

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Total176,845,695187,651,139Less  
treasury stock: 1,879,911 shares at  
September 30, 2000 and  
1,872,585 shares at December 31,  
2000, at  
cost(1,894,893)(1,889,764)

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Total stockholders  
equity174,950,802185,761,375

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**Total**\$235,037,543\$271,061,672

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See notes to unaudited condensed consolidated financial statements.

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**Tweeter Home Entertainment Group, Inc. and Subsidiaries**  
**Condensed Consolidated Statements of Operations**  
**(Unaudited)**

	<b>Three Months Ended December 31,</b>	
	<b>1999</b>	<b>2000</b>
Total revenue	\$ 123,443,294	\$ 161,968,381
Cost of sales(77,796,132)(103,514,885)		
<hr/>		
Gross Profit45,647,16258,453,496		
Selling expenses26,981,94936,388,883		
Corporate, general and administrative expenses4,647,3026,061,338		
Amortization of goodwill331,892480,000		
<hr/>		
Income from operations13,686,01915,523,275		
Income from joint venture107,349485,206		
Interest income (expense)(256,863)321,509		
<hr/>		
Income before income taxes13,536,50516,329,990		
Income taxes5,414,6026,531,996		
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<b>NET INCOME</b> \$8,121,903\$9,797,994		
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Basic earnings per share\$0.53\$0.53		
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Diluted earnings per share\$0.48\$0.51		
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Weighted average shares outstanding: Basic15,276,82518,481,100		
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Diluted17,044,27819,237,496		
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See notes to unaudited condensed consolidated financial statements.

**Table of Contents****Tweeter Home Entertainment Group, Inc. and Subsidiaries****Condensed Consolidated Statements of Cash Flows****(Unaudited)****Three months ended  
December 31,****1999                      2000****CASH FLOWS FROM OPERATING ACTIVITIES:**

Net

income\$8,121,903\$9,797,994Adjustments  
to reconcile net income to net cash  
provided by operating  
activities:Depreciation and  
amortization1,570,2502,329,930Equity  
earnings in joint venture  
investment(107,349)(485,207)Gain  
on disposal of  
equipment(10,300)(5,000)Changes  
in operating assets and liabilities,  
net of effects from acquisition of  
business:Increase in accounts  
receivable(9,040,857)(13,679,964)Increase  
in  
inventory(5,756,373)(5,601,946)Increase  
in prepaid expenses and other  
assets179,825164,758Increase in  
accounts payable and accrued  
expenses17,141,13217,844,040Increase  
in customer  
deposits1,050,8342,204,648Increase  
in deferred  
rent110,683185,331Decrease in  
deferred  
warranty(203,055)(128,475)Decrease  
in other liabilities(228,680)

Net cash provided by operating  
activities12,828,01312,626,109

**CASH FLOWS FROM  
INVESTING****ACTIVITIES:**Purchase of

property and  
equipment(4,065,582)(4,155,931)Proceeds  
from sale of property and  
equipment10,3005,000Purchase of  
marketable equity  
securities (200,000)Investment in  
joint  
venture(2,675,203) Acquisition of  
businesses(100,321)(3,837,048)

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Net cash used in investing  
activities(6,830,806)(8,187,979)

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**CASH FLOWS FROM  
FINANCING**

**ACTIVITIES:**Amount due to  
bank2,209,118(191,289)Payments  
of long-term  
debt(5,714,299)(9,363)Other  
equity transactions236,203156,846

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Net cash provided (used) by  
financing  
activities(3,268,978)(43,806)

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**INCREASE IN CASH AND  
CASH  
EQUIVALENTS**2,728,2294,394,324**CASH  
AND CASH EQUIVALENTS,  
BEGINNING OF  
PERIOD**999,49534,292,555

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**CASH AND CASH  
EQUIVALENTS, END OF  
PERIOD**\$3,727,724\$38,686,879

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**SUPPLEMENTAL  
DISCLOSURES OF CASH  
FLOW INFORMATION:**Cash  
paid during the period  
for:Interest\$203,003\$4,569

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Taxes\$989,000\$827,500

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See notes to unaudited condensed consolidated financial statements.

**Table of Contents****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, 2000.

**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 accruals) considered necessary for a fair presentation of the interim consolidated financial statements have been included. Operating results for the three-month period ended December 31, 2000 are not necessarily indicative of the results that may be expected for the fiscal year ending September 30, 2001. Tweeter typically records its highest revenue and earnings in this first fiscal quarter.

**3. Earnings per Share**

Tweeter computed earnings per share in accordance with Statement of Financial Accounting Standards ( SFAS ) No. 128, Earnings Per Share. Basic earnings per share is calculated based on the weighted average number of common shares outstanding. Diluted earnings per share is based on the weighted average number of common shares outstanding, adjusted for the nominal issuance of certain warrants and dilutive potential common shares (common stock options and warrants).

The following is a reconciliation of the numerators and denominators of the basic and diluted earnings per share:

	<b>Three Months Ended December 31,</b>	
	<b>1999</b>	<b>2000</b>
<b>Basic Earnings Per Share:</b>		
Numerator: Net		
income \$8,121,903	\$9,797,994	
Denominator: Weighted		
average common shares		
outstanding 15,276,825	18,481,100	
	<hr/>	<hr/>
Basic earnings per share	\$0.53	\$0.53
	<hr/>	<hr/>



**Diluted Earnings Per**

**Share:** Numerator \$8,121,903 \$9,797,994 Denominator: Weighted  
 average shares  
 outstanding 15,276,825 18,481,100 Potential  
 common stock  
 outstanding 1,767,453 756,396

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Total 17,044,278 19,237,496

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Diluted earnings per  
 share \$0.48 \$0.51

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**4. Comprehensive Income**

Comprehensive income for the three months ended December 31, 1999 and December 31, 2000 was as follows:

	<b>Three Months Ended December 31,</b>	
	<b>1999</b>	<b>2000</b>
Net income	\$8,121,903	\$9,797,994
Change in fair value of long-term investments (net of tax) 453,809(474,148)		
<hr/>		
Comprehensive income \$8,575,712 \$9,323,846		
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**5. Douglas TV**

On October 2, 2000, Tweeter completed the acquisition of the retail operations of Douglas TV, Inc. ( Douglas TV ). Douglas TV has four stores in the greater Chicago area, and reported retail revenue of approximately \$30 million for calendar 1999. This transaction is being accounted for as a purchase. Tweeter's total purchase price was \$5.78 million in cash and shares of its common stock from its shelf registration filed on April 13, 1999 with the Securities and Exchange Commission. The results of operations for the acquired entity in the fiscal quarter ended December 31, 2000 were not significant. Accordingly, pro forma information has not been presented. The allocation of the purchase price resulted in goodwill to date of approximately \$3,086,000, which is being amortized over twenty years using the straight-line method. The net assets acquired at fair market value on October 2, 2000 were allocated as follows:

Inventory	\$5,427,000
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Property and  
equipment 1,939,000  
Accounts  
receivable/Prepays 246,000  
Other  
current  
liabilities (2,739,000)  
Deferred  
Warranty (1,886,000)

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Net assets  
purchased 2,987,000  
Total  
purchase price and  
related costs  
(including the issuance  
of 36,849 shares of  
common stock with a  
fair market value of  
\$1,330,000) 6,073,000

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Goodwill \$3,086,000

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## 6. New Accounting Pronouncements

During 1998, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards ( SFAS ) No. 133, Accounting for Derivative Instruments and Hedging Activities . SFAS No. 133 was not required to be implemented until fiscal year 2000. In June 1999, the FASB issued SFAS No. 137, Accounting for Derivative Instruments and Hedging Activities-Deferral of the Effective Date of FASB Statement No. 133 an amendment of FASB Statement No. 133. SFAS No. 137 delayed the original implementation date of SFAS No. 133 by one year. In June 2000, the FASB issued SFAS 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities, an amendment of FASB Statement No. 133. Tweeter has implemented FASB Statement No. 133 during this quarter and there is no effect on the consolidated financial statements.

On December 3, 1999, the Securities and Exchange Commission published Staff Accounting Bulletin ( SAB ) No. 101, Revenue Recognition in Financial Statements. This SAB summarizes certain of the staff s views in applying generally accepted accounting principles to revenue recognition in financial statements. This SAB requires, among other things, that revenues derived from products or services in which companies typically act as an agent be reported on a net basis. Tweeter implemented SAB No. 101 during the quarter ended December 31, 2000 and the net effect was a reduction in total revenues and cost of sales of \$1,842,000 and \$1,369,000 for the quarter ended December 31, 1999. The adoption of SAB No. 101 did not have any imp act on the results of operations for the quarter ended December 31, 2000.

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### 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 96 stores under the Tweeter, Bryn Mawr Stereo & Video, HiFi Buys, United Audio Centers and Douglas TV names.

**RESULTS OF OPERATIONS****THREE MONTHS ENDED DECEMBER 31, 2000 AS COMPARED TO THREE MONTHS ENDED DECEMBER 31, 1999**

*Total Revenue.* Total revenue includes delivered sales, completed service center work orders, insurance replacement and corporate sales. Total revenue increased \$38.5 million, or 31.2%, to \$162.0 million for the three months ended December 31, 2000 from \$123.4 million for the three months ended December 31, 1999. The increase was mainly comprised of \$11.4 million from new stores, a comparable store sales increase of \$1.5 million, and \$24.8 million derived by sales from the acquisitions of United Audio Centers and Douglas TV. Comparable store sales, excluding United Audio Centers and Douglas TV, increased by 1.3%. The United Audio Centers and Douglas TV stores had a comparable store sales decrease of 10.4%. Digital technology products continued to drive sales in the first quarter of fiscal 2001. Digital product sales in all categories exceeded 43% of revenues for the quarter. Digital and digital ready projection televisions accounted for over 79% of all projection TV sales, and 13.8% of the total revenue. Projection television sales were up from last year 19.3% for the quarter ended December 31, 2000. Digital and digital ready tube televisions accounted for almost 40% of all tubes sold in the quarter ended December 31, 2000, and represented 5.1% of total revenue. Tube television sales were up 12.0% for the quarter from last year. Digital camcorder sales represented almost 85% of the category and digital receivers represented 75% of the receiver category.

*Gross Profit.* Cost of sales includes merchandise, net delivery costs, distribution costs, purchase discounts, and vendor volume rebates. Cost of sales increased \$25.7 million, or 33.1%, to \$103.5 million for the three months ended December 31, 2000 from \$77.8 million for the three months ended December 31, 1999. Gross profit increased \$12.8 million, or 28.1%, to \$58.5 million for the three months ended December 31, 2000 from \$45.6 million for the three months ended December 31, 1999. The gross margin percentage decreased 90 basis points, to 36.1% for the three months ended December 31, 2000, from 37.0% for the three months ended December 31, 1999. The decrease in margin was primarily due to the acquisition of Douglas TV, which for the quarter had a higher mix of video than Tweeter's other stores. Douglas TV stores had a 24 basis point negative impact for the quarter. In addition, the Company had an overall increase in video as part of the total product mix. Video gross margins are not typically as high as the other product categories. Lastly, Tweeter had higher than planned for distribution costs, which are included in cost of goods. This is primarily due to running three separate facilities in the Chicago marketplace in the first quarter. This accounted for 35 basis points of the gross margin decline.

*Selling Expenses.* Selling expenses include the compensation of store personnel, occupancy costs, store level depreciation, advertising expenses, pre-opening expenses and credit card fees and excludes corporate, general and administrative expenses. Selling expenses increased \$9.4 million, or 34.9%, to \$36.4 million for the three months ended December 31, 2000 from \$27.0 million for the three months ended December 31, 1999. As a percentage of revenue, selling expenses increased to 22.5% for the three months ended December 31, 2000 from 21.9% for the three months ended December 31, 1999. This increase was primarily due to higher payroll costs associated with increased infrastructure of the home installation departments.

*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 30.4% to \$6.1 million for the three months ended December 31, 2000 from \$4.6 million for the three months ended December 31, 1999. As a percentage of total revenue, corporate general and administrative expenses decreased to 3.7% for the three months ended December 31, 2000 from 3.8% for the three months ended December 31, 1999. This decrease was the result of leveraging the additional sales volume of new stores and the acquisitions of United Audio Centers and Douglas TV.

*Amortization of Goodwill.* Amortization of goodwill increased to \$480,000 for the three months ended December 31, 2000 from \$332,000 for the three months ended December 31, 1999. The increase was due to the

completion of the United Audio Centers acquisition on April 1, 2000 and the Douglas TV acquisition on October 2, 2000.

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*Net Interest Income (Expense).* Net interest income increased to \$322,000 for the three months ended December 31, 2000 from a net interest expense of \$257,000 for the three months ended December 31, 1999. The increase was due to the elimination of outstanding debt with the proceeds from our follow-on offering on February 7, 2000 and investment income realized on our outstanding cash balances.

*Income Taxes.* The effective tax rate for the fiscal quarters ended December 31, 2000 and December 31, 1999 was 40.0%. Tweeter expects that the income tax rate for the fiscal year ending September 30, 2001 will remain substantially unchanged.

*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 this 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.

## **LIQUIDITY AND CAPITAL RESOURCES**

Net cash provided by operating activities was \$12.6 million for the three months ended December 31, 2000 compared to \$12.8 million in cash provided by operating activities for the three months ended December 31, 1999. Cash used by operations in 2000 was primarily the result of increases in inventory of \$5.6 million and accounts receivable of \$13.7 million. Cash generated from operations included, primarily, an increase in accounts payable and accrued expenses of \$17.8 million, \$9.8 million in net income and an increase in customer deposits of \$2.2 million. The adjustments to reconcile net income to cash provided by operating activities consist primarily of \$2.3 million for depreciation and amortization, as well as minor changes in other operating accounts.

At December 31, 2000, working capital was \$89.0 million, compared to \$83.5 million at September 30, 2000. The ratio of current assets to current liabilities was 2.12 to 1 at December 31, 2000 and 2.51 to 1 at September 30, 2000. Capital expenditures for the three months ended December 31, 2000 were \$4.2 million, primarily used for the building of new stores and the relocation of existing stores.

Net cash used by financing activities during the three months ended December 31, 2000 was \$44,000.

Tweeter had available at December 31, 2000 a \$50,000,000 revolving credit facility, and there were no balances outstanding at December 31, 2000.

On October 2, 2000, Tweeter completed the acquisition of certain assets and liabilities of Douglas TV. This transaction was accounted for as a purchase and, accordingly, the results of operations of the Company's business relating to Douglas TV are included in the consolidated statements of operations from the acquisition date. The total purchase price, including acquisition costs to date, was approximately \$6.1 million, \$1.3 million of which was paid through the issuance of 36,849 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**

During 1998, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards ( SFAS ) No. 133, Accounting for Derivative Instruments and Hedging Activities . SFAS No. 133 was not required to be implemented until fiscal year 2000. In June 1999, the FASB issued SFAS No. 137, Accounting for Derivative Instruments and Hedging Activities-Deferral of the Effective Date of FASB Statement No. 133 an amendment of FASB Statement No. 133. SFAS No. 137 delayed the original implementation date of SFAS No. 133 by one year. In June 2000, the FASB issued SFAS 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities, an amendment of FASB Statement No.

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133. Tweeter has implemented FASB Statement No. 133 during this quarter and there is no effect on the consolidated financial statements.

On December 3, 1999, the Securities and Exchange Commission published Staff Accounting Bulletin ( SAB ) No. 101, Revenue Recognition in Financial Statements. This SAB summarizes certain of the staff's views in applying generally accepted accounting principles to revenue recognition in financial statements. This SAB requires, among other things, that revenues derived from products or services in which companies typically act as an agent be reported on a net basis. Tweeter implemented SAB No. 101 during the quarter ended December 31, 2000 and the net effect was a reduction in total revenues and cost of sales of \$1,842,000 and \$1,369,000 for the quarter ended December 31, 1999. The adoption of SAB No. 101 did not have any impact on the results of operations for the quarter ended December 31, 2000.

### **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 2001, 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-3 (SEC file number 333-94433) on January 11, 2000 and in the Company's Annual Report on Form 10-K filed on December 18, 2000, 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**

Tweeter's credit facility provides for borrowings which bear interest at variable rates based on either (i) the higher of Fleet National Bank's Base Rate or the Federal Funds rate plus 0.50% or (ii) the London Interbank Offering Rate (LIBOR) plus an applicable margin varying from 100 to 175 basis points. Tweeter had no borrowings outstanding pursuant to the credit facility as of December 31, 2000. Tweeter believes that the effect, if any, of reasonably possible near-term changes in interest rates on Tweeter's financial position, results of operations, and cash flows should not be

material.

At December 31, 2000, the Company had approximately \$1.1 million in marketable equity securities classified as available-for-sale. 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 approximately \$110,000.

Currently, Tweeter does not enter into financial instrument transactions for speculative purposes or to manage interest rate exposure.

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**PART II. OTHER INFORMATION**

**ITEM 5. OTHER INFORMATION**

None

**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: January 31, 2001

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