

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.

| TITLE OF CLASS | OUTSTANDING AT JANUARY 31, 2001 |
|-------------------------------|--|
| 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**

| September 30, 2000 | December 31, 2000 |
|-----------------------------------|----------------------------------|
| <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 85,967,261 196,995,823

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

Other Long-Term

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

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

Total
liabilities60,086,74185,300,297

Stockholders EquityPreferred
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

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)

Total stockholders
equity174,950,802185,761,375

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

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)

| | Three Months Ended December 31, | |
|--|--|----------------|
| | 1999 | 2000 |
| 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 | | |
| <hr/> | | |
| NET INCOME \$8,121,903\$9,797,994 | | |
| <hr/> | | |
| Basic earnings per share\$0.53\$0.53 | | |
| <hr/> | | |
| Diluted earnings per share\$0.48\$0.51 | | |
| <hr/> | | |
| Weighted average shares outstanding: Basic15,276,82518,481,100 | | |
| <hr/> | | |
| Diluted17,044,27819,237,496 | | |
| <hr/> | | |

See notes to unaudited condensed consolidated financial statements.

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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)

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

**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

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

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

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

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

Taxes\$989,000\$827,500

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:

| | Three Months Ended December 31, | |
|----------------------------------|--|-------------|
| | 1999 | 2000 |
| Basic Earnings Per Share: | | |
| 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

Total 17,044,278 19,237,496

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:

| | Three Months Ended December 31, | |
|--|--|-------------|
| | 1999 | 2000 |
| 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 | | |
| <hr/> | | |
| <hr/> | | |

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 |
|-----------|-------------|

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

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

Goodwill \$3,086,000

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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