TWEETER HOME ENTERTAINMENT GROUP INC
Form 10-Q
February 10, 2004

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, 2003

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 by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). 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 FEBRUARY 6, 2004
Common Stock, $.01 par value	24,157,848

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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, 2003	December 31, 2003
		(Unaudited)
Assets		
Current Assets:		
Cash and cash equivalents	$ 1,850,449	$ 2,870,933
Accounts receivable, net of allowance for doubtful accounts of $1,110,000 at September 30, 2003 and $1,253,000 at December 31, 2003	18,263,564	26,110,999
Inventory	117,569,528	145,839,912
Deferred tax assets	5,938,916	6,698,256
Prepaid expenses and other current assets	26,930,455	14,862,689
Total current assets	170,552,912	196,382,789
Property and equipment, net	126,220,975	125,131,044
Long-term investments	2,113,020	2,255,856
Deferred tax assets	5,217,877	4,147,774
Intangible assets, net	1,926,667	1,756,667
Other assets, net	2,404,938	2,809,082
Total	$ 308,436,389	$ 332,483,212
Liabilities and Stockholders Equity		
Current Liabilities:		
Current portion of long-term debt	$ 7,364,925	$ 27,701,671
Accounts payable	32,493,675	24,660,161
Accrued expenses	22,735,570	27,236,388
Customer deposits	21,168,837	22,819,583
Deferred warranty	215,381	184,942
Total current liabilities	83,978,388	102,602,745
Long-Term Debt	48,266,937	47,910,723
Other Long-Term Liabilities:		
Rent related accruals	11,056,253	11,081,972
Deferred warranty	98,262	69,488
Total other long-term liabilities	11,154,515	11,151,460
Total liabilities	143,399,840	161,664,928
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; 25,748,489 shares issued at September 30, 2003 and 25,813,671 at December 31, 2003	257,485	258,137
Additional paid in capital	294,969,338	295,476,274
Unearned equity compensation	(408,142)	(273,318)
Accumulated other comprehensive income (loss)	(15,931)	7,762
Accumulated deficit	(127,967,415)	(122,859,966)
Total	166,835,335	172,608,889
	(1,798,786)	(1,790,605)

Less treasury stock: 1,742,616 shares at September 30, 2003 and 1,730,929 shares at December 31, 2003, at cost		
Total stockholders equity	165,036,549	170,818,284
Total	$ 308,436,389	$ 332,483,212

See notes to unaudited condensed consolidated financial statements.

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Tweeter Home Entertainment Group, Inc. and Subsidiaries
Consolidated Statements of Income
(Unaudited)

	Three Months Ended December 31, 2002	Three Months Ended December 31, 2003
Total revenue	$ 249,649,877	$ 255,239,751
Cost of sales	(162,634,064)	(158,469,644)
Gross Profit	87,015,813	96,770,107
Selling expenses	66,457,094	76,033,765
Corporate, general and administrative expenses	11,385,544	11,897,283
Amortization of intangibles	170,000	170,000
Income from operations	9,003,175	8,669,059
Income from equity investment	57,430	272,276
Interest expense	(391,746)	(654,593)
Interest income	5,070	225,673
Income before income taxes	8,673,929	8,512,415
Income taxes	3,469,572	3,404,966
NET INCOME	$ 5,204,357	$ 5,107,449
Basic earnings per share	$ 0.22	$ 0.21
Diluted earnings per share	$ 0.22	$ 0.21
Weighted average shares outstanding:		
Basic	23,565,397	23,923,099
Diluted	24,026,667	24,641,583

See notes to unaudited condensed consolidated financial statements.

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Tweeter Home Entertainment Group, Inc. and Subsidiaries
Consolidated Statements of Cash Flows

	Three Months Ended December 31,	
	2002	**2003**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 5,204,357	5,107,449
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	5,034,142	5,634,325
Noncash compensation		134,824
Loss on disposal of property and equipment	122,943	73,942
Provision for uncollectible accounts	32,115	174,928
Tax benefit from options exercised		50,367
Deferred income tax (benefit) provision	(334,035)	294,968
Amortization of deferred gain on sale leaseback		11,211
Income from equity investment	(57,430)	(272,276)
Changes in operating assets and liabilities:		
Increase in accounts receivable	(2,240,845)	(8,022,363)
Increase in inventory	(18,918,297)	(28,262,217)
Decrease in prepaid expenses and other assets	1,069,580	11,378,622
Increase (decrease) in accounts payable and accrued expenses	31,291,577	(3,304,261)
Increase in customer deposits	1,259,681	1,650,746
Increase in deferred rent	35,732	14,508
Decrease in deferred warranty	(143,104)	(59,213)
Net cash provided by (used in) operating activities	22,356,416	(15,394,440)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(9,953,225)	(4,169,786)
Proceeds from sale of property and equipment		6,450
Distributions from equity investment		132,326
Net cash used in investing activities	(9,953,225)	(4,031,010)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Increase in amount due to bank	1,638,607	20,379,337
Net payments of debt	(14,978,072)	(398,805)
Proceeds from options exercised	58,877	371,535
Proceeds from employee stock purchase plan	97,372	93,867
Net cash (used in) provided by financing activities	(13,183,216)	20,445,934
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(780,025)	1,020,484
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	2,282,635	1,850,449
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 1,502,610	2,870,933
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid (received) during the period for:		
Interest	$ 397,332	$ 785,535

Taxes	$ 561,000	$ (7,200,671)

See notes to unaudited condensed 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, 2003.

2. Accounting Policies

The unaudited condensed 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 three-month period ended December 31, 2003 are not necessarily indicative of the results that may be expected for the fiscal year ending September 30, 2004. Tweeter typically records its highest revenue and earnings in this first fiscal quarter.

Vendor Allowances, Allowance for Bad and Doubtful Accounts Accounts receivable are primarily due from the vendors from which the Company buys its product. The various types of accounts receivable are for purchase rebate allowances, cooperative advertising allowances, returned merchandise and warranty work performed by the Company s service departments.

Cash discounts earned for timely payments of merchandise invoices are recognized in the income statement upon the sale of the related inventory.

Purchase rebate allowances and general cooperative advertising allowances are earned based on the purchase of inventory and are recorded in accounts receivable when the inventory is purchased. The carrying value of inventory is initially reduced by the amount of purchase rebates earned, resulting in lower cost of goods sold when the inventory is sold. Certain vendor agreements include stretch goals where the level of funds earned is dependent upon the Company achieving certain purchase levels. These program funds are recorded as a reduction of inventory costs when it is determined that it is likely that the Company will achieve the goal.

Vendor rebates earned based on specific advertising activities and other activities are recognized as a reduction to advertising expense as these activities are performed and only to the extent that the cost of the activities equals or exceeds the amount of the rebates.

When the Company returns merchandise to a vendor, typically because it is defective, the Company records a receivable for the value of the merchandise returned and reduces the inventory balance.

The Company sells products that come with a manufacturer s warranty, but the Company has service centers that repair products. When the Company repairs products that are still under manufacturer s warranty, the vendor reimburses the Company for the parts and the technician s labor. Once the product is repaired, the Company establishes a receivable for the amounts due from the vendor and records warranty revenue.

During the quarter ended March 31, 2003, Tweeter adopted EITF 02-16, Accounting by a Customer for Certain Consideration Received from a Vendor (EITF 02-16) which addresses how and when to reflect consideration received from vendors in the consolidated financial statements. Under EITF 02-16, certain consideration received from vendors that would have previously been recorded as a reduction to selling expenses, is now recorded as a reduction to cost of goods sold. The amount of reimbursements received during the quarter ended December 31, 2003 that were treated as a reduction of cost of goods sold but which would have been recorded as a reduction of advertising expenses (selling expenses) prior to EITF 02-16 amounted to $10.3 million.

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Advertising Gross advertising including electronic media, newspaper, buyer s guides and direct mailings, are expensed when released. For the three months ended December 31, 2002 and 2003 gross advertising was $16.1 million and $15.9 million, respectively. Cooperative advertising, for specific advertising activities received from vendors, offsetting our gross advertising expense, amounted to $9.1 million and $1.2 million for the three months ended December 31, 2002 and 2003, respectively, resulting in net advertising of $7.0 million and $14.7 million for the three months ended December 31, 2002 and 2003, respectively.

Stock-based compensation Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation, addresses the financial accounting and reporting standards for stock or other equity-based compensation arrangements. The Company accounts for stock based compensation to employees using the intrinsic method. The Company provides disclosures based on the fair value as permitted by SFAS No. 123. Stock or other equity-based compensation for non-employees must be accounted for under the fair value-based method as required by SFAS No. 123 and EITF No. 96-18, Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services, and other related interpretations. Under this method, the equity-based instrument is valued at either the fair value of the consideration received or the equity instrument issued on the date of grant. The resulting compensation cost is recognized and charged to operations over the service period, which is usually the vesting period.

For purposes of determining the disclosures required by SFAS No. 123, the fair value of each stock option granted in the three months ended December 31, 2002 and December 31, 2003 under the Company s stock option plan was estimated on the date of grant using the Black-Scholes option-pricing model. Key assumptions used to apply this pricing model were as follows:

	Three Months Ended December 31,	
	2002	**2003**
Risk free interest rate	2.62%	3.46%
Expected life of options grants	5.1	7.2
Expected volatility of underlying stock	82.13%	87.53%

Had compensation cost for the Company s stock option plans been determined using the fair value method, pro forma net income and pro forma diluted earnings per share would have been:

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	Three Months Ended December 31,	
	2002	2003
Net income as reported	$ 5,204,357	$ 5,107,449
Total stock-based employee compensation expense recorded, net of related -tax effects		80,894
Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(1,255,975)	(1,616,034)
Pro forma net income	$ 3,948,382	$ 3,572,309
Earnings per share		
Basic - as reported	$ 0.22	$ 0.21
Basic - pro forma	$ 0.17	$ 0.15
Diluted - as reported	$ 0.22	$ 0.21
Diluted - pro forma	$ 0.16	$ 0.14

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 December 31,	
	2002	2003
Basic Earnings Per Share:		
Numerator:		
Net income	$ 5,204,357	$ 5,107,449
Denominator:		
Weighted average common shares outstanding	23,565,397	23,923,099
Basic earnings per share	$ 0.22	$ 0.21
Diluted Earnings Per Share:		
Numerator:	$ 5,204,357	$ 5,107,449
Denominator:		
Weighted average shares outstanding	23,565,397	23,923,099
Potential common stock outstanding	461,270	718,484
Total	24,026,667	24,641,583
Diluted earnings per share	$ 0.22	$ 0.21

Anti dilutive options not included in earnings per share calculation	768,533	3,088,814