

TRANS WORLD ENTERTAINMENT CORP

Form 10-Q

June 12, 2014

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**FORM 10-Q**

<sup>S</sup> QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED MAY 3, 2014

OR

<sup>£</sup> TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_

COMMISSION FILE NUMBER: 0-14818

TRANS WORLD ENTERTAINMENT CORPORATION

(Exact name of registrant as specified in its charter)

New York

(State or other jurisdiction of incorporation or organization)

14-1541629

(I.R.S. Employer  
Identification Number)

38 Corporate Circle  
Albany, New York 12203  
(Address of principal  
executive offices, including  
zip code)

(518) 452-1242  
(Registrant's  
telephone  
number,

including area  
code)

Indicate by a check mark whether the Registrant (1) has filed all reports required to be filed by Sections 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for 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 S No ☒

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definition of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☒ Accelerated filer S Non-accelerated filer ☒  
Smaller reporting company ☒

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☒ No S

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

Common Stock, \$.01 par value,

31,870,363 shares outstanding as of May 30, 2014

**TRANS WORLD ENTERTAINMENT CORPORATION AND SUBSIDIARIES**

**QUARTERLY REPORT ON FORM 10-Q**

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**TRANS WORLD ENTERTAINMENT CORPORATION AND SUBSIDIARIES****PART 1. FINANCIAL INFORMATION****Item 1 - Financial Statements****CONDENSED CONSOLIDATED BALANCE SHEETS****(in thousands, except per share and share amounts)****(unaudited)**

	May 3, 2014	February 1, 2014	May 4, 2013
<b>ASSETS</b>			
<b>CURRENT ASSETS:</b>			
Cash and cash equivalents	\$90,088	\$131,002	\$111,276
Merchandise inventory	140,138	150,167	153,519
Other current assets	9,759	9,798	10,528
Total current assets	239,985	290,967	275,323
<b>NET FIXED ASSETS</b>	14,944	12,419	8,961
<b>OTHER ASSETS</b>	9,132	9,031	8,589
<b>TOTAL ASSETS</b>	<b>\$264,061</b>	<b>\$312,417</b>	<b>\$292,873</b>
<b>LIABILITIES</b>			
<b>CURRENT LIABILITIES:</b>			
Accounts payable	\$46,999	\$77,625	\$51,608
Accrued expenses and other current liabilities	7,212	7,375	8,965
Accrued Incentives	627	498	7,705
Deferred revenue	9,569	10,092	10,606
Current portion of capital lease obligations	1,101	1,066	967
Total current liabilities	65,508	96,656	79,851
<b>CAPITAL LEASE OBLIGATIONS, less current portion</b>	649	938	1,750
<b>OTHER LONG-TERM LIABILITIES</b>	23,109	23,027	23,850
<b>TOTAL LIABILITIES</b>	<b>89,266</b>	<b>120,621</b>	<b>105,451</b>
<b>SHAREHOLDERS' EQUITY</b>			
Preferred stock (\$0.01 par value; 5,000,000 shares authorized; none issued)	—	—	—
Common stock (\$0.01 par value; 200,000,000 shares authorized; 58,316,668, 58,298,668 and 58,166,572 shares issued, respectively)	583	583	582
Additional paid-in capital	315,022	314,932	314,320
Treasury stock at cost (26,320,550, 26,108,846 and 25,102,990 shares, respectively)	(223,762)	(222,948)	(217,555)
Accumulated other comprehensive income/(loss)	26	(119 )	(2,594 )
Retained earnings	82,926	99,348	92,669
<b>TOTAL SHAREHOLDERS' EQUITY</b>	<b>174,795</b>	<b>191,796</b>	<b>187,422</b>

TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$264,061	\$312,417	\$292,873
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*See Accompanying Notes to Condensed Consolidated Financial Statements.*

**TRANS WORLD ENTERTAINMENT CORPORATION AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(in thousands, except per share amounts)

(unaudited)

	Thirteen Weeks Ended	
	May 3, 2014	May 4, 2013
Net sales	\$87,216	\$93,934
Cost of sales	54,439	58,145
Gross profit	32,777	35,789
Selling, general and administrative expenses	32,633	33,659
Income from operations	144	2,130
Interest expense, net	483	484
Income (loss) before income tax expense	(339 )	1,646
Income tax expense	47	48
Net income (loss)	\$(386 )	\$1,598
<b>BASIC AND DILUTED INCOME (LOSS) PER SHARE:</b>		
Basic income (loss) per share	\$(0.01 ) \$0.05	
Weighted average number of common shares outstanding – basic	32,089	32,287
Diluted income (loss) per share	\$(0.01 ) \$0.05	
Weighted average number of common shares outstanding – diluted	32,089	32,571

*See Accompanying Notes to Condensed Consolidated Financial Statements.*

**TRANS WORLD ENTERTAINMENT CORPORATION AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**

**(in thousands)**

**(unaudited)**

	Thirteen Weeks Ended	
	May 3, 2014	May 4, 2013
Net income (loss)	\$(386)	\$1,598
Amortization of pension costs	145	179
Comprehensive income (loss)	\$(241)	\$1,777

*See Accompanying Notes to Condensed Consolidated Financial Statements.*

**TRANS WORLD ENTERTAINMENT CORPORATION AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(in thousands)****(unaudited)**

	Thirteen Weeks Ended	
	May 3, 2014	May 4, 2013
Net cash used by operating activities	\$(20,352 )	\$(25,320 )
Cash flows from investing activities:		
Purchases of fixed assets	(3,489 )	(949 )
Net cash used by investing activities	(3,489 )	(949 )
Cash flows from financing activities:		
Cash dividends paid	(16,036 )	—
Payments of capital lease obligations	(254 )	(223 )
Exercise of stock options	31	4,786
Purchase of treasury stock	(814 )	—
Net cash provided (used) by financing activities	(17,073 )	4,563
Net decrease in cash and cash equivalents	(40,914 )	(21,706 )
Cash and cash equivalents, beginning of period	131,002	132,982
Cash and cash equivalents, end of period	\$90,088	\$111,276
Issuance of shares under deferred share plan	—	\$50

*See Accompanying Notes to Condensed Consolidated Financial Statements.*



**TRANS WORLD ENTERTAINMENT CORPORATION AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)**

**May 3, 2014 and May 4, 2013**

**Note 1. Nature of Operations**

Trans World Entertainment Corporation and subsidiaries (“the Company”) is one of the largest specialty retailers of entertainment products, including video, music, electronics, trend, video games and related products in the United States. The Company operates a chain of retail entertainment stores, primarily under the names f.y.e. for your entertainment and Suncoast Motion Pictures, and e-commerce sites, [www.fye.com](http://www.fye.com), [www.wherehouse.com](http://www.wherehouse.com), and [www.secondspin.com](http://www.secondspin.com) in a single industry segment. As of May 3, 2014, the Company operated 333 stores totaling approximately 2.0 million square feet in the United States and the Commonwealth of Puerto Rico.

***Liquidity and Cash Flows:***

The Company’s primary sources of working capital are cash and cash equivalents on hand, cash provided by operations and borrowing capacity under its revolving credit facility (See Note 6 for further details). The Company’s cash flows fluctuate from quarter to quarter due to various items, including seasonality of sales and earnings, merchandise inventory purchases and returns and the related terms on the purchases and capital expenditures. Management believes it will have adequate resources to fund its cash needs for the next twelve months and beyond, including its capital spending, its seasonal increase in merchandise inventory and other operating cash requirements and commitments.

Management anticipates that any future cash requirements due to a shortfall in cash from operations would be funded by the Company’s cash and cash equivalents on hand and its revolving credit facility.

***Seasonality:***

The Company’s business is seasonal, with the fourth fiscal quarter constituting the Company’s peak selling period. In fiscal 2013, the fourth quarter accounted for approximately 35% of annual net sales. In anticipation of increased sales activity in the fourth quarter, the Company purchases additional inventory and hires seasonal associates to supplement its core store sales and distribution center staffs. If, for any reason, the Company’s sales were below seasonal norms during the fourth quarter, the Company’s operating results could be adversely affected. Quarterly sales can also be affected by the timing of new product releases, new store openings, store closings and the performance of existing stores.

**Note 2: Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements consist of Trans World Entertainment Corporation, its wholly-owned subsidiary, Record Town, Inc. ("Record Town"), and Record Town's subsidiaries, all of which are wholly-owned. All significant intercompany accounts and transactions have been eliminated.

The interim condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. The information furnished in these unaudited condensed consolidated financial statements reflects all normal, recurring adjustments which, in the opinion of management, are necessary for the fair presentation of such financial statements. The preparation of financial statements in conformity with accounting principles generally accepted in the

United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. During the first quarter of fiscal 2014, the company recorded an adjustment to correct the liability for workers' compensation claims related to a prior period, which increased Selling, General and Administrative Expenses and decreased Net Income by approximately \$700,000. The cumulative effect of this adjustment is deemed immaterial. Certain information and footnote disclosures normally included in the financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to rules and regulations applicable to interim financial statements.

Selling, general and administrative expenses include miscellaneous income and expense items, other than interest. The Company recorded miscellaneous income items of \$1.3 million for both of the thirteen weeks ending May 3, 2014 and May 4, 2013.

The information presented in the accompanying unaudited condensed consolidated balance sheet as of February 1, 2014 has been derived from the Company's February 1, 2014 audited consolidated financial statements. All other information has been derived from the Company's unaudited condensed consolidated financial statements as of and for the thirteen weeks ended May 3, 2014 and May 4, 2013. These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended February 1, 2014.

The Company's significant accounting policies are the same as those described in Note 1 to the Company's Consolidated Financial Statements on Form 10-K for the fiscal year ended February 1, 2014.

### **Note 3. Recently Adopted Accounting Pronouncements**

In April 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-08, Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity, ("ASU 2014-08"). This amendment changes the requirements for reporting discontinued operations and includes enhanced disclosures about discontinued operations. Under the amendment, only those disposals of components of an entity that represent a strategic shift that has a major effect on an entity's operations and financial results will be reported as discontinued operations in the financial statements. ASU 2014-08 is effective prospectively for annual periods beginning on or after December 15, 2014, and interim reporting periods within those years. Early adoption is permitted. The Company expects to adopt ASU 2014-08 as of the beginning of 2015 and it does not anticipate the adoption of ASU 2014-08 to have a material impact on the Company's consolidated financial position, cash flows, or results of operations.

**Note 4. Stock Based Compensation**

Total stock-based compensation expense recognized in the condensed consolidated statements of operations for the thirteen weeks ended May 3, 2014 and May 4, 2013 was \$60,000 and \$99,000, respectively, before income taxes. No deferred tax benefit was recorded against stock-based compensation expense for the thirteen weeks ended May 3, 2014 and May 4, 2013.

As of May 3, 2014, there was approximately \$0.5 million of unrecognized compensation cost related to stock award awards that is expected to be recognized as expense over a weighted average period of 1.6 years.

As of May 3, 2014, stock awards authorized for issuance under the Company's plans total 12.8 million. There are certain authorized stock awards for which the Company no longer grants awards. Of these awards authorized for issuance, 2.1 million were granted and are outstanding, 1.6 million of which were vested and exercisable. Awards available for future grants at May 3, 2014 were 2.7 million.

The following table summarizes stock award activity during the thirteen weeks ended May 3, 2014:

	Employee and Director Stock Award Plans				
	Number of Shares Subject To Option	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Other Share Awards <sup>(1)</sup>	Weighted Average Grant Fair Value
Balance February 1, 2014	2,907,190	\$ 8.07	2.90	10,941	\$ 9.50
Granted	—	—	—	1,467	3.73
Exercised	(18,000 )	1.73	—	—	—
Forfeited	—	—	—	—	—
Canceled	(752,590 )	10.31	—	—	—
Balance May 3, 2014	2,136,600	\$ 7.33	3.54	12,408	\$ 8.82
Exercisable May 3, 2014	1,612,850	\$ 8.66	2.15	12,408	\$ 8.82

(1) Other Share Awards include deferred shares granted to Directors.

As of May 3, 2014, the intrinsic value of stock awards outstanding was \$478,000 and exercisable was \$183,000.

**Note 5. Defined Benefit Plans**

The Company maintains a non-qualified Supplemental Executive Retirement Plan (“SERP”) for certain executive officers of the Company. The SERP provides eligible executives defined pension benefits that supplement benefits under other retirement arrangements.

Prior to June 1, 2003, the Company had provided the Board of Directors with a noncontributory, unfunded retirement plan (“Director Retirement Plan”) that paid retired directors an annual retirement benefit. Directors who were not yet vested in their retirement benefits as of June 1, 2003 had the present value of benefits already accrued as of the effective date converted to deferred shares of the Company’s Common Stock. Directors that were fully or partially vested in their retirement benefits were given a one-time election to continue to participate in the current retirement program or convert the present value of their benefits to deferred shares.

The measurement date for the SERP and Director Retirement Plan is fiscal year end, using actuarial techniques which reflect estimates for mortality, turnover and expected retirement. In addition, management makes assumptions concerning future salary increases. Discount rates are generally established as of the measurement date using theoretical bond models that select high-grade corporate bonds with maturities or coupons that correlate to the expected payouts of the applicable liabilities.

The following represents the components of the net periodic pension cost related to the Company's SERP and Director Retirement Plan for the respective periods:

	Thirteen weeks ended	
	May 3, 2014	May 4, 2013
	(in thousands)	
Service cost	\$ 14	\$ 28
Interest cost	172	164
Amortization of prior service cost	180	180
Amortization of net gain	(35 )	(1 )
Net periodic pension cost	\$ 331	\$ 371

During the thirteen weeks ended May 3, 2014, the Company did not make any cash contributions to the SERP or the Director Retirement Plan, and presently expects to pay approximately \$103,000 in benefits relating to the SERP and \$34,000 in benefits relating to the Director Retirement Plan during Fiscal 2014.

#### **Note 6. Line of Credit**

In May 2012, the Company entered into a \$75 million credit facility ("Credit Facility") which amended the previous credit facility. The principal amount of all outstanding loans under the Credit Facility together with any accrued but unpaid interest, are due and payable in May 2017, unless otherwise paid earlier pursuant to the terms of the Credit Facility. Payments of amounts due under the Credit Facility are secured by the assets of the Company.

The Credit Facility includes customary provisions, including affirmative and negative covenants, which include representations, warranties and restrictions on additional indebtedness and acquisitions. The Credit Facility also includes customary events of default, including, among other things, material adverse effect, bankruptcy, and certain changes of control. The Credit Facility also contains other terms and conditions, including limitations on the payment of dividends and covenants around the number of store closings. The Company is compliant with all covenants.

Interest under the Credit Facility will accrue, at the election of the Company, at a Base Rate or LIBO Rate, plus, in each case, an Applicable Margin, which is determined by reference to the level of availability, with the Applicable Margin for LIBO Rate loans ranging from 2.25% to 2.75% and the Applicable Margin for Prime Rate loans ranging from 0.75% to 1.25%. In addition, a commitment fee ranging from 0.375% to 0.50% is also payable on unused commitments.

The availability under the Credit Facility is subject to limitations based on inventory levels.

During the first quarters of 2014 and 2013, the Company did not have any borrowings under the Credit Facility. As of May 3, 2014 and May 4, 2013, the Company had no outstanding letter of credit obligations and \$378,000 of outstanding letter of credit obligations under the Credit Facility,

respectively. The Company had \$47 million and \$54 million available for borrowing as of May 3, 2014 and May 4, 2013, respectively.

#### **Note 7. Accumulated Other Comprehensive Income/Loss**

Accumulated other comprehensive income/loss that the Company reports in the condensed consolidated balance sheets represents the difference between the accrued pension liability and accrued benefit cost, net of taxes, associated with the Company's defined benefit plans. Comprehensive income (loss) consists of net income and the reclassification of pension costs previously reported in comprehensive income (loss) for the thirteen weeks ended May 3, 2014 and May 4, 2013.

#### **Note 8. Depreciation and Amortization of Fixed Assets**

Depreciation and amortization of fixed assets included in the condensed consolidated statements of operations is as follows:

	Thirteen Weeks Ended May 3, 2014    May 4, 2013	
	(in thousands)	
Cost of sales	\$ 123	\$ 124
Selling, general and administrative expenses	782	824
Total	\$905	\$948

#### **Note 9. Income/ Loss Per Share**

Basic income (loss) per share is calculated by dividing net income (loss) by the weighted average common shares outstanding for the period. Diluted income per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock (net of any assumed repurchases) that then shared in the earnings of the Company, if any. It is computed by dividing net income (loss) by the sum of the weighted average shares outstanding and additional common shares that would have been outstanding if the dilutive potential common shares had been issued for the Company's common stock awards from the Company's Stock Award Plans.



Weighted average shares are calculated as follows:

	Thirteen weeks ended	
	May 3, 2014	May 4, 2013
	(in thousands)	
Weighted average common shares outstanding – basic	32,089	32,287
Dilutive effect of employee stock options	—	284
Weighted average common shares outstanding—diluted	32,089	32,571
Anti-dilutive stock options	1,685	2,396

**Note 10. Shareholders' Equity**

During the thirteen weeks ended May 3, 2014, the Company repurchased approximately 212,000 shares of common stock at an average price of \$3.84 per share, for an aggregate purchase price of \$0.8 million, including direct fees related to the purchase of shares, leaving approximately \$18.6 million available for purchase under the \$22.0 million share repurchase program approved by the Company's Board of Directors in the third quarter of 2013. The Company classified the repurchased shares as treasury stock on the Company's balance sheet.

On March 6, 2014, our board of directors declared a special cash dividend of \$0.50 per common share, with an ex-dividend date of March 18, 2014. The total special dividend payout was \$16 million.

**TRANS WORLD ENTERTAINMENT CORPORATION AND SUBSIDIARIES**

**PART 1. FINANCIAL INFORMATION**

**Item 2 - Management's Discussion and Analysis of Financial Condition and**

**Results of Operations**

**May 3, 2014 and May 4, 2013**

**Overview**

Management's Discussion and Analysis of Financial Condition and Results of Operations provides information that the Company's management believes necessary to achieve an understanding of its financial statements and results of operations. To the extent that such analysis contains statements which are not of a historical nature, such statements are forward-looking statements, which involve risks and uncertainties. These risks include, but are not limited to, changes in the competitive environment for the Company's merchandise, including the entry or exit of non-traditional retailers of the Company's merchandise to or from its markets; releases by the music, video and video games industries of an increased or decreased number of "hit releases"; general economic factors in markets where the Company's merchandise is sold; and other factors discussed in the Company's filings with the Securities and Exchange Commission. The following discussion and analysis of the Company's financial condition and results of operations should be read in conjunction with the unaudited condensed consolidated financial statements and related notes included elsewhere in this report and the audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended February 1, 2014.

At May 3, 2014, the Company operated 333 stores totaling approximately 2.0 million square feet in the United States, the District of Columbia and the Commonwealth of Puerto Rico. The Company's stores offer predominantly entertainment product, including video and music. In total, these two categories represented 76% of the Company's net sales for the thirteen weeks ended May 3, 2014. The balance of categories, including trend, electronics, video games and related products represented 24% of the Company's net sales for the thirteen weeks ended May 3, 2014.

The Company's results have been, and will continue to be, contingent upon management's ability to understand industry trends and to manage the business in response to those trends and general economic trends. Management monitors a number of key performance indicators to evaluate its performance, including:

**Net sales and comparable store net sales:** The Company measures and reports the rate of comparable store net sales change. A store is included in comparable store net sales calculations at the beginning of its thirteenth full month of operation. Stores relocated/expanded or downsized are excluded from comparable store net sales if the change in square footage is greater than 20%. Closed stores that were open for at least thirteen months are included in comparable store net sales through the month immediately preceding the month of closing. The Company further analyzes net sales by store format and by product category.

**Cost of Sales and Gross Profit:** Gross profit is impacted primarily by the mix of products sold, by discounts negotiated with vendors and discounts offered to customers. The Company records its distribution and product shrink expenses in cost of sales. Distribution expenses include those costs associated with receiving, shipping, inspecting and warehousing product and costs associated with product returns to vendors. Cost of sales further includes obsolescence costs and is reduced by the benefit of vendor allowances, net of direct reimbursements of expense.

**Selling, General and Administrative (“SG&A”) Expenses:** Included in SG&A expenses are payroll and related costs, occupancy charges, general operating and overhead expenses and depreciation charges (excluding those related to distribution operations, as disclosed in Note 8 to the condensed consolidated financial statements). Selling, general and administrative expenses also include fixed asset write offs associated with store closures, if any, and miscellaneous income and expense items, other than interest.

**Balance Sheet and Ratios:** The Company views cash, net inventory investment (merchandise inventory less accounts payable) and working capital (current assets less current liabilities) as relevant indicators of its financial position. See Liquidity and Capital Resources for further discussion of these items.

## RESULTS OF OPERATIONS

### Thirteen Weeks Ended May 3, 2014

### Compared to the Thirteen Weeks Ended May 4, 2013

The following table sets forth a period over period comparison of the Company’s net sales by category:

	Thirteen Weeks Ended				Comp	
	May 3, 2014	May 4, 2013	Change	%	Store Net Sales	
	(in thousands, except store data)					
Net sales	\$87,216	\$93,934	\$(6,718)	(7.2%)	0.3	%
As a % of sales						
Video	47.7	% 46.9	%		2.4	%
Music	28.5	% 30.1	%		(6.2	%)
Trend	10.8	% 9.5	%		11.0	%
Electronics	8.4	% 9.1	%		(8.3	%)
Video Games	4.6	% 4.4	%		17.1	%
Store Count:	333	353	(20	) (5.7%)		

**Net sales:** Comparable sales increased 0.3% for the first quarter due to positive comparable sales in the video, trend, and video games categories. Net sales decreased 7.2% during the thirteen weeks ended May 3, 2014, as compared to the same period last year. The decline in net sales for the thirteen week period resulted from a decrease in store count of 5.7% and an 8.3% decrease in square footage in operation.

***Video:***

Comparable store net sales in the video category increased 2.4% during the thirteen weeks ended May 3, 2014. The video category represented 47.7% of total net sales for the thirteen weeks ended May 3, 2014 compared to 46.9% in the comparable quarter last year. Video comparable sales were driven by the release of Frozen and strong catalog sales.

According to Warner Brothers Home Video, industry sales were down 5.9% during the period corresponding to the Company's first fiscal quarter.

***Music:***

Comparable store net sales in the music category decreased 6.2% during the thirteen weeks ended May 3, 2014. The music category represented 28.5% of total net sales for the thirteen weeks ended May 3, 2014 compared to 30.1% in the comparable quarter last year.

According to Soundscan, total physical CD unit sales industry-wide were down 21.4% during the period corresponding to the Company's first fiscal quarter.

***Trend:***

Comparable store net sales in the trend category increased 11.0% during the thirteen weeks ended May 3, 2014. Trend product represented 10.8% of total net sales for the thirteen weeks ended May 3, 2014 compared to 9.5% in the comparable quarter last year.

***Electronics:***

Comparable store net sales in the electronics category decreased 8.3% during the thirteen weeks ended May 3, 2014. Electronics net sales represented 8.4% of total net sales for the thirteen weeks ended May 3, 2014 compared to 9.1% in the comparable quarter last year.

***Video Games:***

Comparable store net sales for video games increased 17.1% during the thirteen weeks ended May 3, 2014. Games sales were driven by sales of new hardware platforms. Currently, 88 stores, or 26.4% of the Company's stores carry games.

According to NPD Group, industry sales were up 8.4% for the quarter. Video games net sales represent 4.6% of total net sales for the thirteen weeks ended May 3, 2014 compared to 4.4% in the comparable quarter last year.

**Gross Profit.** The following table sets forth a period over period comparison of the Company's gross profit:

<b>Thirteen weeks ended</b>		<b>Change</b>	
<i>(in thousands)</i>			
May 3, 2014	May 4, 2013	\$	%

Gross Profit	\$32,777	\$35,789	\$(3,012)	(8.4%)
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As a % of net sales	37.6	%	38.1	%
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Gross profit decreased 8.4% for the thirteen weeks ended May 3, 2014 as compared to the comparable period last year. The decrease in gross profit as a percentage of sales was due to increased promotional activity.

**SG&A Expenses.** The following table sets forth a period over period comparison of the Company's SG&A expenses:

	<b>Thirteen weeks ended</b>		<b>Change</b>	
	<i>(in thousands)</i>			
	<b>May 3, 2014</b>	<b>May 4, 2013</b>	<b>\$</b>	<b>%</b>
SG&A	\$32,633	\$33,659	\$(1,026)	(3.0%)

As a % of net sales	37.4	%	35.8	%
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For the thirteen weeks ended May 3, 2014, SG&A expenses decreased \$1.0 million, or 3.0% on the net sales decline of 7.2% resulting in a 160 basis point increase in SG&A expenses as a percentage of net sales. The increase in SG&A as a percentage of net sales is due to higher than historical adjustments for employee related expenses year over year, including an adjustment to correct the liability for workers' compensation claims related to a prior period, of approximately \$700,000. and loss of leverage on fixed expenses due to the sales decline.

**Interest Expense, Net.** Net interest expense was \$483,000 during the thirteen weeks ended May 3, 2014, compared to \$484,000 during the thirteen weeks ended May 4, 2013. Net interest expense consists primarily of interest on capital leases, unused commitment fees and the amortization of fees related to the Company's credit facility.

**Income Tax Expense (Benefit).** In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent on the generation of future taxable income. Management considers the scheduled reversal of taxable temporary differences, projected future taxable income and tax planning strategies in making this assessment. Based on available objective evidence, management concluded that a full valuation allowance should be recorded against the Company's deferred tax assets. Management will continue to assess the need for and amount of the valuation allowance against the deferred tax assets by giving consideration to all available evidence to the Company's ability to generate future taxable income in its conclusion of the need for a full valuation allowance. Any reversal of the Company's valuation allowance will favorably impact its results of operations in the period of reversal. The Company is currently unable to determine whether or when that reversal might occur, but it will continue to assess the realizability of its deferred tax assets and will adjust the valuation allowance if it is more likely than not that all or a portion of the deferred tax assets will become realizable in the future. The Company has significant net operating loss carry forwards and other tax attributes that are available to offset projected taxable income and current taxes payable, if any, for the year ending January 31, 2015. The deferred tax impact resulting from the utilization of the net operating loss carry forwards and other tax attributes will be offset by a reduction in the valuation allowance. As of February 1, 2014, the Company had a net operating loss carry forward of \$157.6 million for federal income tax purposes and approximately \$244 million for state income tax purposes that expire at various times through 2031 and are subject to certain limitations and statutory expiration periods.

For the thirteen week periods ended May 3, 2014 and May 4, 2013, the Company's current tax expense was associated with quarter-specific items attributable to interest accruals on related uncertain tax positions and state taxes based on modified gross receipts incurred for these thirteen week periods.

**Net Income (Loss).** The following table sets forth a period over period comparison of the Company's net income (loss):

	Thirteen weeks ended		
	May 3, 2014	May 4, 2013	Change
	<i>(in thousands)</i>		
Income (loss) before income tax	(\$339)	\$1,646	\$(1,985)
Income tax expense	47	48	(1)
Net income (loss)	(\$386)	\$1,598	\$(1,984)

For the thirteen weeks ended May 3, 2014, the Company's net income decreased approximately \$2.0 million to a loss of \$386,000 from income of \$1.6 million for the thirteen weeks ended May 4, 2013. The decrease was due to the decline in gross profit from lower sales, increased promotional activity and a prior period adjustment, recorded in the thirteen weeks ended May 3, 2014, of approximately \$700,000.

## LIQUIDITY

**Liquidity and Cash Flows:** The Company's primary sources of working capital are cash and cash equivalents on hand, cash provided by operations and borrowing capacity under its revolving credit facility (See Note 6 to the condensed consolidated financial statements for further details). The Company's cash flows fluctuate from quarter to quarter due to various items, including seasonality of net sales and earnings, merchandise inventory purchases and returns and the related terms on the purchases and capital expenditures. Management believes it will have adequate resources to fund its cash needs for the next twelve months and beyond, including its capital spending, its seasonal increase in merchandise inventory and other operating cash requirements and commitments.

Management anticipates that any future cash requirements due to a shortfall in cash from operations would be funded by the Company's cash and cash equivalents on hand and its revolving credit facility, discussed hereafter. The Company does not expect any material changes in the mix (between equity and debt) or the relative cost of capital resources.

The following table sets forth a summary of key components of cash flow and working capital for each of the thirteen weeks ended May 3, 2014 and May 4, 2013, or at those dates:

	As of or for the Thirteen weeks ended	Change
(in thousands)		\$

	May 3, 2014	May 4, 2013	
Operating Cash Flows	\$(20,352 )	\$(25,320 )	\$4,968
Investing Cash Flows	(3,489 )	(949 )	(2,540 )
Financing Cash Flows	(17,073 )	4,563	(21,636)
Capital Expenditures	(3,489 )	(949 )	(2,540 )
Cash and Cash Equivalents	90,088	111,276	(21,188)
Merchandise Inventory	140,138	153,519	(13,381)
Working Capital	174,477	195,472	(20,996)

The Company had cash and cash equivalents of \$90.1 million at May 3, 2014, compared to \$131.0 million at February 1, 2014 and \$111.3 million at May 4, 2013. Merchandise inventory was \$71 per square foot at May 3, 2014 the same level as of May 4, 2013.

Cash used by operating activities was \$20.4 million for the thirteen weeks ended May 3, 2014. The primary use of cash was a \$30.6 million seasonal reduction of accounts payable, partially offset by a \$10.0 million reduction in inventory. The Company's merchandise inventory and accounts payable are influenced by the seasonality of its business. A significant reduction of accounts payable occurs annually in the fiscal first quarter, reflecting payments for merchandise inventory sold during the prior year's holiday season.

Cash used by investing activities, which was constituted entirely of capital expenditures, was \$3.5 million for the thirteen weeks ended May 3, 2014.

Cash used by financing activities was \$17.1 million for the thirteen weeks ended May 3, 2014. The primary uses of cash were the purchases of common stock for \$814,000 and a dividend payment of \$16.0 million.

During the thirteen weeks ended May 3, 2014, the Company repurchased approximately 212,000 shares of common stock at an average price of \$3.84 per share, for an aggregate purchase price of approximately \$814,000, leaving approximately \$18.6 million available for purchase under the stock repurchase program approved by the Board of Directors.

On March 6, 2014, our board of directors declared a special cash dividend of \$0.50 per common share, with an ex-dividend date of March 18, 2014. The total special dividend payout was \$16.0 million.

Since December 26, 2012, the Company has returned over \$37 million to shareholders through special dividends, a tender offer and the share repurchase program as of May 3, 2014.

In May 2012, the Company entered into a \$75 million credit facility ("Credit Facility") which amended the previous credit facility. The principal amount of all outstanding loans under the Credit Facility together with any accrued but unpaid interest, are due and payable in May 2017, unless otherwise paid earlier pursuant to the terms of the Credit Facility. Payments of amounts due under the Credit Facility are secured by the assets of the Company.

The Credit Facility includes customary provisions, including affirmative and negative covenants, which include representations, warranties and restrictions on additional indebtedness and acquisitions. The Credit Facility also includes customary events of default, including, among other things, material adverse effect, bankruptcy, and certain

changes of control. The Credit Facility also contains other terms and conditions, including limitations on the payment of dividends and covenants around the number of store closings. The Company is compliant with all covenants.

Interest under the Credit Facility will accrue, at the election of the Company, at a Base Rate or LIBO Rate, plus, in each case, an Applicable Margin, which is determined by reference to the level of availability, with the Applicable Margin for LIBO Rate loans ranging from 2.25% to 2.75% and the Applicable Margin for Prime Rate loans ranging from 0.75% to 1.25%. In addition, a commitment fee ranging from 0.375% to 0.50% is also payable on unused commitments.

The availability under the Credit Facility is subject to limitations based on sufficient inventory levels.

During the first quarters of 2014 and 2013, the Company did not have any borrowings under the Credit Facility. As of May 3, 2014 and May 4, 2013, the Company had no outstanding letter of credit obligations and \$378,000 of outstanding letter of credit obligations under the Credit Facility, respectively. The Company had \$47 million and \$54 million available for borrowing as of May 3, 2014 and May 4, 2013, respectively.

**Capital Expenditures.** During the thirteen weeks ended May 3, 2014, the Company made capital expenditures of \$3.5 million. The Company currently plans to spend approximately \$15.0 million for capital expenditures in fiscal 2014.

## **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States requires that management apply accounting policies and make estimates and assumptions that affect results of operations and the reported amounts of assets and liabilities in the financial statements. Management continually evaluates its estimates and judgments including those related to merchandise inventory and return costs, income taxes and accounting for gift card liability. Management bases its estimates and judgments on historical experience and other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations included in the Form 10-K for the year ended February 1, 2014 includes a summary of the critical accounting policies and methods used by the Company in the preparation of its condensed consolidated financial statements. There have been no material changes or modifications to the policies since February 1, 2014.

### **Recently Issued Accounting Pronouncements:**

In April 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-08, Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity, ("ASU 2014-08"). This amendment changes the requirements for reporting discontinued operations and includes enhanced disclosures about discontinued operations. Under the amendment, only those disposals of components of an entity that represent a strategic shift that has a major effect on an entity's operations and financial results will be reported as discontinued operations in the financial statements. ASU 2014-08 is effective prospectively for annual periods beginning on or after December 15, 2014, and interim reporting periods within those years. Early adoption is permitted. The Company expects to adopt ASU 2014-08 as of the beginning of 2015 and it does not anticipate the adoption of ASU 2014-08 to have a material impact on the Company's consolidated financial position, cash flows, or results of operations.

**TRANS WORLD ENTERTAINMENT CORPORATION AND SUBSIDIARIES**

**PART I – FINANCIAL INFORMATION**

**Item 3 - Quantitative and Qualitative Disclosures about Market Risk**

To the extent the Company borrows under its Credit Facility, the Company is subject to risk resulting from interest rate fluctuations since interest on the Company's borrowings under its Credit Facility can be variable. Interest under the Credit Facility will accrue, at the election of the Company, at a Base Rate or LIBO Rate, plus, in each case, an Applicable Margin, which is determined by reference to the level of availability as defined in the Credit Agreement, with the Applicable Margin for LIBO Rate loans ranging from 2.25% to 2.75% and the Applicable Margin for Base Rate loans ranging from 0.75% to 1.25%. If interest rates on the Company's Credit Facility were to increase by 25 basis points, and to the extent borrowings were outstanding, for every \$1,000,000 outstanding on the facility, income before income taxes would be reduced by \$2,500 per year. For a discussion of the Company's accounting policies for financial instruments and further disclosures relating to financial instruments, see "Nature of Operations and Summary of Significant Accounting Policies" in the Notes to Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended February 1, 2014. The Company does not currently hold any derivative instruments.

**Item 4 – Controls and Procedures**

(a) Evaluation of disclosure controls and procedures. The Company's Chief Executive Officer and Chief Financial Officer, after evaluating the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in the Securities Exchange Act of 1934 Rules 13a-15(e) and 15d-15(e)) as of May 3, 2014, have concluded that as of such date the Company's disclosure controls and procedures were effective and designed to ensure that (i) information required to be disclosed by the issuer in the reports that it files or submits under the Securities Exchange Act of 1934 (the "Exchange Act") is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and (ii) information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

(b) Changes in internal controls. There have been no changes in the Company's internal controls over financial reporting that occurred during the fiscal quarter covered by this quarterly report that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

**TRANS WORLD ENTERTAINMENT CORPORATION AND SUBSIDIARIES**

**PART II - OTHER INFORMATION**

**Item 1 – Legal Proceedings**

The Company is subject to legal proceedings and claims that have arisen in the ordinary course of its business and have not been finally adjudicated. Although there can be no assurance as to the ultimate disposition of these matters, it is management's opinion, based upon the information available at this time, that the expected outcome of these matters, individually and in the aggregate, will not have a material adverse effect on the results of operations and financial condition of the Company.

**Item 1A – Risk Factors**

Risks relating to the Company's business and Common Stock are described in detail in Item 1A of the Company's most recently filed Annual Report on Form 10-K for the year ended February 1, 2014.

**Item 2 – Unregistered Sales of Equity Securities and Use of Proceeds**

During the third quarter of fiscal 2013, the Company determined that participants in the Trans World Entertainment Corporation 401(k) Savings Plan (the "401(k) Plan") had invested in Company Common Stock (the "Common Stock") under the 401(k) Plan that were not registered under the Securities Act of 1933. Purchases of Common Stock were made on the open market by the 401(k) Plan. Investments in the Common Stock during the third quarter of fiscal 2013 represented 2,568 shares of the Company's Common Stock with an aggregate purchase price equal to \$12,070. Under applicable federal securities laws, certain participants may have a right to rescind their investment and require the Company to repurchase its Common Stock for an amount equal to the price paid for the Common Stock (or if the Common Stock has been sold, to receive damages for any loss that was incurred on the sale), plus interest. Additionally, the Company may be subject to civil and other penalties by regulatory authorities. Generally, the federal statute of limitations applicable to securities rescission rights is one year from the date of acquisition of the security. Investments by the 401(k) Plan in the Common Stock during the preceding twelve months represented 83,389 shares of the Company's Common Stock with a maximum aggregate offering price equal to \$438,626. Based on the May 30, 2014 closing price for the Company's Common Stock, the maximum potential payment for claims based on these rights is under \$250,000.

The failure to register the shares of Common Stock under the 401(k) Plan was inadvertent and the Company intends to make a registered rescission offer to eligible plan participants in the second quarter of fiscal 2014. Based on the current market price of the Company's Common Stock, the Company does not believe the potential liability for rescission claims is material to the Company's financial condition or results of operations.



The Common Stock investment option was closed to participants effective November 15, 2013. No further Common Stock purchases by the 401(k) Plan will be permitted.

Item 3 – Defaults Upon Senior Securities

None.

Item 4 – Mine Safety Disclosure

Not Applicable.

Item 5 – Other Information

None.

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**Item 6 - Exhibits**

**(A) Exhibits -**

<b>Exhibit No.</b>	<b>Description</b>
31.1	Chief Executive Officer certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Chief Financial Officer certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32	Certification pursuant to 18 U.S.C Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document (furnished herewith)
101.SCH	XBRL Taxonomy Extension Schema (furnished herewith)
101.CAL	XBRL Taxonomy Extension Calculation Linkbase (furnished herewith)
101.DEF	XBRL Taxonomy Extension Definition Linkbase (furnished herewith)
101.LAB	XBRL Taxonomy Extension Label Linkbase (furnished herewith)
101.PRE	XBRL Taxonomy Extension Presentation Linkbase (furnished herewith)
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**SIGNATURES**

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

**TRANS WORLD ENTERTAINMENT CORPORATION**

June 12, 2014 **By:** /s/ Robert J. Higgins

Robert J. Higgins  
Chairman and Chief  
Executive Officer  
(Principal Executive  
Officer)

June 12, 2014 **By:** /s/ John Anderson

John Anderson  
Chief Financial Officer  
(Principal and Chief  
Accounting Officer)