

**T r a n s   W o r l d   E n t e r t a i n m e n t**  
**A n n u a l   R e p o r t   2 0 1 2**



**for your entertainment®**

## Chairman's Letter

2012 was an exciting year for Trans World Entertainment. Our Company has faced significant challenges in the past several years and we have answered those challenges with sound strategies that have put us in position to respond to future challenges as well. Our focus for the year was to further improve our operating results, strengthen our financial position and continue the evolution of our product mix.

### Improved operating results

Higher gross margin and lower SG&A rates continue to drive our operating results. Our net income improved in each of the last five years, from a loss of \$69 million in 2008 to net income of \$34 million in 2012, an improvement of \$103 million. Over that period, our gross margin rate improved from 33.5% to 37.5%. The closing of unprofitable stores and prudent overhead expense reductions have driven down our SG&A rate from 38.6% in 2008 to 34.6% in 2012. Our 2012 results include a one-time gain of \$22.8 million from the sale of a non operating asset.

### Financial Strength

The benefit of our improved operating results is evident in our balance sheet. Our financial position has never been stronger and we have had no borrowings at any point in the last two years. Our financial strength afforded us the opportunity to amend our credit facility providing for reduced interest rates, lower costs and other positive terms. The amended facility helps ensure our ability to fund growth and strategic initiatives in the future.

In addition to amending our credit facility, the Company was able to reward our shareholders with a special dividend, the first in our over 40 year history.

### Growth Initiatives

In addition to providing a return to our shareholders, our financial flexibility and working capital provides us with resources to fund our growth initiatives. Our primary growth initiatives are to expand our store base profitably and to continue the evolution of our product mix and store experience towards expanding categories, while maximizing opportunity in our core categories of video and music.

#### *Expanding Store Base*

For the last several years, our real estate strategy focused on rationalizing our store portfolio to a profitable core through rent reductions and store closings. We will continue to close underperforming stores going forward since it is good business practice to do so. That said, the majority of our store closings are behind us and the opportunity for future growth exists in the over 500 quality shopping malls in the U.S. without an entertainment store.

#### *Evolution of Product Mix—Expanding Categories*

During 2012, for the first time in our history, the combined categories of trend and electronics represented over 20% of our annual sales. The exciting lineup of products that we've added – and will continue to add – to our stores expands on our mission of providing all things entertainment to our customers. Our unique ability to present our customers with a full range of products that feature the hottest entertainment properties makes our f.y.e. stores a one stop shop for entertainment enthusiasts.

#### *Evolution of Product Mix—Core Categories*

In the Video category, the industry has been challenged with growing competition from non-traditional formats. However, we have been able to achieve comp sales increases through a greater focus on catalog and value pricing.

In Music, we continue to focus on offering the customer the best selection, at the best value. As more competitors reduce their inventory selection or exit the business all together, we will drive sales by being the destination for a broad selection of well priced titles, which present a great value to our customers.

Anticipating new trends and evolving with our customer's needs - we are committed to being a total entertainment destination for our customers, while delivering on our commitment to enhance shareholder value.

I would like to thank our shareholders, board of directors, customers and our associates for their support and dedication. We are moving forward and our Company is well positioned to face new challenges and capitalize on new opportunities.

Sincerely,



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

**FORM 10-K**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934  
FOR THE FISCAL YEAR ENDED FEBRUARY 2, 2013**

**OR**

**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)**

**Securities registered pursuant to Section 12(b) of the Act: None**

**Securities registered pursuant to Section 12(g) of the Act: Common Stock, \$0.01 par value**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in the Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant's Knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or an amendment to this Form 10-K.

Indicate by checkmark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company (as defined in Rule 12b-2 of the Act).

Large accelerated filer  Accelerated filer  Non-accelerated filer  Small reporting company

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

As of July 28, 2012, 31,455,004 shares of the Registrant's Common Stock, excluding 25,102,990 shares of stock held in Treasury, were issued and outstanding. The aggregate market value of the voting stock held by non-affiliates of the Registrant, based upon the closing sale price of the Registrant's Common Stock on July 28, 2012 as reported on the National Market tier of The NASDAQ Stock Market, Inc. was \$51,222,703. Shares of Common Stock held by the Company's controlling shareholder, who controlled approximately 46.4% of the outstanding Common Stock, have been excluded for purposes of this computation. Because of such shareholder's control, shares owned by other officers, directors and 5% shareholders have not been excluded from the computation. As of March 31, 2013, there were 31,914,606 shares of Common Stock Issued and Outstanding.

**Documents of Which Portions Are Incorporated by Reference**

Proxy Statement for Trans World Entertainment Corporation's  
July 2, 2013 Annual Meeting of Shareholders  
to be filed on or about May 31, 2013

**Parts of the Form 10-K into Which Portion of Documents are Incorporated**

III

## PART I

### Cautionary Statement for Purposes of the “Safe Harbor” Provisions of the Private Securities Litigation Reform Act of 1995

This document includes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements relate to analyses and other information that are based on forecasts of future results and estimates of amounts not yet determinable. These statements also relate to the Trans World Entertainment Corporation’s (“the Company’s) future prospects, developments and business strategies. The statements contained in this document that are not statements of historical fact may include forward-looking statements that involve a number of risks and uncertainties.

We have used the words “anticipate”, “believe”, “could”, “estimate”, “expect”, “intend”, “may”, “plan”, “predict”, “project”, and similar terms and phrases, including references to assumptions, in this document to identify forward-looking statements. These forward-looking statements are made based on management’s expectations and beliefs concerning future events and are subject to uncertainties and factors relating to our operations and business environment, all of which are difficult to predict and many of which are beyond the Company’s control, that could cause actual results to differ materially from those matters expressed in or implied by these forward-looking statements. The following factors are among those that may cause actual results to differ materially from the Company’s forward-looking statements.

- new product introductions (“hit releases”);
- accelerated declines in compact disc (“CD”) and DVD industry sales;
- highly competitive nature of the retail entertainment business;
- new technology, including digital downloading;
- competitive pricing;
- current economic conditions;
- dependence on key employees and the ability to hire new employees;
- the Company’s level of debt and related restrictions and limitations;
- future cash flows;
- availability of real estate;
- vendor terms;
- interest rate fluctuations;
- adverse publicity;
- product liability claims, and
- change in laws.

The reader should keep in mind that any forward-looking statement made by us in this document, or elsewhere, pertains only as of the date on which we make it. New risks and uncertainties come up from time-to-time and it’s impossible for us to predict these events or how they may affect us. In light of these risks and uncertainties, you should keep in mind that any forward-looking statements made in this report or elsewhere might not occur.

In addition, the preparation of financial statements in accordance with accounting principles generally accepted in the United States (“GAAP”) requires us to make estimates and assumptions. These estimates and assumptions affect:

- the reported amounts and timing of revenue and expenses,
- the reported amounts and classification of assets and liabilities, and
- the disclosure of contingent assets and liabilities.

Actual results may vary from our estimates and assumptions. These estimates and assumptions are based on historical results, assumptions that we make, as well as assumptions by third-parties.

## Item 1. BUSINESS

### Company Background

Trans World Entertainment Corporation, which, together with its consolidated subsidiaries, is referred to herein as “the Company”, “we”, “us” and “our”, was incorporated in New York in 1972. We own 100% of the outstanding common stock of Record Town, Inc., through which our principal operations are conducted. The Company operates retail stores and three e-commerce sites and is one of the largest specialty retailers of entertainment products, including; video, music, electronics, trend, video games and related products in the United States.

#### *Stores and Store Concepts*

As of February 2, 2013, the Company operated 358 stores totaling approximately 2.2 million square feet in the United States, the District of Columbia and the Commonwealth of Puerto Rico.

#### *Mall Stores*

As of February 2, 2013, the Company operated 304 mall-based stores, predominantly under the f.y.e. (“For Your Entertainment”) brand, including:

*f.y.e. stores.* The Company operated 290 traditional mall based stores. f.y.e. stores average about 5,800 square feet and carry a full complement of entertainment products, including video, music, electronics, trend, video games and related products.

*Video only stores.* The Company operated 14 video only stores, under the Suncoast Motion Pictures and Saturday Matinee brands. These stores specialize in the sale of video and related accessories. They are located in large, regional shopping malls and average about 2,500 square feet.

#### *Freestanding Stores*

As of February 2, 2013, the Company operated 54 freestanding stores predominantly under the f.y.e. brand. They carry a full complement of entertainment products, including video, music, electronics, trend, video games and related products and are located in freestanding, strip center and downtown locations. The freestanding stores average approximately 9,300 square feet.

#### *E-Commerce Sites*

The Company operates three retail web sites including, [www.fye.com](http://www.fye.com), [www.wherehouse.com](http://www.wherehouse.com) and [www.secondspin.com](http://www.secondspin.com).

### Merchandise Categories

Net sales by merchandise category as a percentage of total net sales for Fiscal 2012, 2011 and 2010 were as follows:

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Video .....	43.8%	42.3%	43.7%
Music .....	30.9	34.2	35.5
Electronics .....	10.5	9.7	7.9
Trend .....	10.1	8.6	7.2
Video games .....	4.7	5.2	5.7
Total .....	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>

### Business Environment

Based primarily on statistical information obtained from Warner Brothers Home Entertainment, Nielsen Sound Scan (“Soundscan”), and NPD; physical video, music and video game software and

accessories represent an approximately \$23 billion industry nationwide. Video, music and video game software and accessories accounted for approximately 79% of the Company's net sales in Fiscal 2012 versus 82% of sales in Fiscal 2011.

According to statistics obtained from Warner Brothers Home Entertainment, overall video industry physical retail sales in 2012 were \$8.2 billion compared to \$8.6 billion in 2011, a decrease of 5%. Industry DVD retail sales decreased 9% in 2012 compared to 2011, while Blu-ray sales increased 9%.

According to statistical information from SoundScan, the total number of music albums sold, including CD and digital albums, decreased 5% to approximately 315 million units in 2012. Excluding digital albums, in Fiscal 2012, album sales decreased 14% from Fiscal 2011 to approximately 191 million units.

## Competition

Physical media sales have suffered from the shift of content to digital distribution and specialty retailers have been impacted by the proliferation of mass merchants (e.g., Wal-Mart and Target), electronics superstores (e.g., Best Buy), and online retailers (e.g. Amazon) that offer entertainment products at discounted prices and collectively have gained a larger share of the market. As a result of such competition, the number of specialty and independent retailers has decreased dramatically due to their reliance on sales of physical product. The Company has diversified its products and taken other measures to position itself competitively within its industry. The Company believes it effectively competes in the following ways:

- Location and convenience: a strength of the Company is its convenient store locations that are often the exclusive retailer in regional shopping centers offering a full complement of entertainment products;
- Selection and assortment: the Company maintains a high in-stock position in a large assortment of products, particularly DVDs, Blu-ray and CDs and a compelling assortment of portable electronics, accessories and the latest entertainment trend products;
- Marketing: the Company uses email blasts, social networking, newspaper and radio and in-store visual displays to market to consumers;
- Customer service: the Company offers personalized customer service in its stores.

## Seasonality

The Company's business is seasonal, with its fourth fiscal quarter constituting the Company's peak selling period. In Fiscal 2012, the fourth quarter accounted for approximately 36% of annual net sales. The fourth quarter for Fiscal 2012 consisted of 14 weeks. 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 net 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 or closings and the performance of existing stores.

## Advertising

The Company makes use of visual displays including in-store signage and external banners. It uses a mass-media marketing program, including newspaper, radio, and television advertisements, as well as sending email blasts and social networking. Certain vendors from whom the Company purchases merchandise offer advertising allowances, of varying duration and amount, to promote their merchandise.

## Suppliers and Purchasing

The Company purchases inventory from approximately 500 suppliers. In Fiscal 2012, 63% of purchases were made from ten suppliers including EMI Music Distribution, Sony Music Entertainment, Warner Music Group, Universal Music Group Distribution, Fox Video Inc., Paramount Home Entertainment Inc., Walt Disney Studios Home Entertainment, Warner Home Entertainment, Universal Studios Home Entertainment and Sony Pictures Home Entertainment. The Company does not have material long-term purchase contracts; rather, it purchases products from its suppliers on an order-by-order basis. Historically, the Company has not experienced difficulty in obtaining satisfactory sources of supply and management believes that it will continue to have access to adequate sources of supply.

## Trade Customs and Practices

Under current trade practices with large suppliers, retailers of music and video products are generally entitled to return unsold merchandise they have purchased in exchange for other merchandise carried by the suppliers. The four largest music suppliers charge a related merchandise return penalty or return handling fee. Most manufacturers and distributors of video products do not charge a return penalty or handling fee. Under current trade practices with large suppliers, retailers of electronics, trend, video games and related products may receive markdown support from suppliers to help clear discontinued or slow turning merchandise. Merchandise return policies and other trade practices have not changed significantly in recent years. The Company generally adapts its purchasing policies to changes in the policies of its largest suppliers.

## Employees

As of February 2, 2013, the Company employed approximately 3,400 people, of whom approximately 1,300 were employed on a full-time basis. Others were employed on a part-time basis. The Company hires seasonal sales and distribution center employees during its fourth quarter peak selling season to ensure continued levels of personalized customer service and in stock position. Assistant store managers, store managers, district managers and regional managers are eligible to receive incentive compensation based on the sales and/or profitability of stores for which they are responsible. Sales support managers are generally eligible to receive incentive compensation based on achieving Company performance targets. None of the Company's employees are covered by collective bargaining agreements and management believes that the Company enjoys favorable relations with its employees.

## Trademarks

The trademarks, f.y.e. for your entertainment, Suncoast Motion Pictures and Saturday Matinee are registered with the U.S. Patent and Trademark Office and are owned by the Company. We believe that our rights to these trademarks are adequately protected. We hold no material patents, licenses, franchises or concessions; however, our established trademarks and trade names are essential to maintaining our competitive position in the entertainment retail industry.

## Information Systems

The Company utilizes primarily IBM AS400 technology to run its management information systems, including its merchandising, distribution and financial systems. Management believes its systems contribute to enhanced customer service and operational efficiency, as well as provide the ability to monitor critical performance indicators versus plans and historical results.

## Available Information

The Company's headquarters are located at 38 Corporate Circle, Albany, New York 12203, and its telephone number is (518) 452-1242. The Company's corporate website address is [www.twec.com](http://www.twec.com). The Company makes available, free of charge, its Exchange Act Reports (Forms 10-K, 10-Q, 8-K

and any amendments thereto) on its web site as soon as practical after the reports are filed with the Securities and Exchange Commission (“SEC”). The public may read and copy any materials the Company files with the SEC at the SEC’s Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Information on the operation of the Public Reference Room can be obtained by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. This information can be obtained from the site <http://www.sec.gov>. The Company’s Common Stock, \$0.01 par value, is listed on the NASDAQ National Market under the trading symbol “TWMC”. The Company’s fiscal year end is the Saturday closest to January 31. The Fiscal 2012 (“Fiscal 2012”) year ended on February 2, 2013; Fiscal 2011 (“Fiscal 2011”) year ended on January 28, 2012; and Fiscal 2010 (“Fiscal 2010”) year ended on January 29, 2011. Fiscal 2012 consisted of 53 weeks. All other periods presented were 52 weeks.

#### **Item 1A. RISK FACTORS**

The following is a discussion of certain factors, which could affect the financial results of the Company.

##### **The Company’s results of operations are affected by the availability of new products.**

The Company’s business is affected by the release of “hit” music and video titles, which can create fluctuations in sales. It is not possible to determine the timing of these fluctuations or the future availability of hit titles. The Company is dependent upon the major music and movie producers to continue to produce hit products. To the extent that new hit releases are not available, or not available at prices attractive to consumers, or, if manufacturers fail to introduce or delay the introduction of new products, the Company’s results of operations may be adversely affected.

##### **The Company’s results of operations are affected by the continued declines in the video and music industries.**

The video and music retailing industries are mature industries and have experienced declines in recent years. Physical video and music represent our largest product categories in terms of sales and have been impacted by new distribution channels, including digital distribution and internet fulfillment. As a result, the Company has had negative comparable store sales for the past five years.

##### **The Company’s results of operations may suffer if the Company does not accurately predict consumer acceptance of new product or distribution technologies.**

The entertainment industry is characterized by changing technology, evolving format standards, frequent new and enhanced product introductions and rapid product obsolescence. These characteristics require the Company to respond quickly to technological changes and understand the impact of these changes on customers’ preferences. If the Company is unable to participate in new product or distribution technologies, its results of operations may suffer. Specifically, CD and DVD formats have experienced a continuous decline as digital forms of music and video content have become more prevalent. If the Company does not timely adapt to these changing technologies or sufficiently focus on the other core categories, operating results could significantly suffer.

##### **Increased competition from existing retailers, including internet retailers, could adversely affect the Company’s results of operations.**

The Company competes with a wide variety of entertainment retailers, including deep-discount retailers, mass merchandisers, consumer electronics outlets, internet retailers and independent operators, some of whom have greater financial and other resources than the Company and frequently sell their product at discounted prices or with added value.



In addition, the Company's success depends on our ability to positively differentiate ourselves from other retailers. The retail business is highly competitive. In the past the Company has been able to compete successfully by differentiating our customer shopping experience by creating an attractive value proposition through a careful combination of price, merchandise assortment, convenience, customer service and marketing efforts. Customer perceptions regarding our stores, our in-stock position and deep assortment of product are also factors in our ability to compete. No single competitive factor is dominant, and actions by our competitors on any of these factors could have an adverse effect on our sales, gross profit and expenses. If we fail to continue to positively differentiate ourselves from our competitors, our results of operations could be adversely affected.

**The Company's business is influenced by general economic conditions.**

The Company's performance is subject to general economic conditions and their impact on levels of discretionary consumer spending. General economic conditions impacting discretionary consumer spending include, among others, wages and employment, consumer debt, reductions in net worth, residential real estate and mortgage markets, taxation, fuel and energy prices, interest rates, consumer confidence and other macroeconomic factors.

Consumer purchases of discretionary items, such as our merchandise, generally decline during recessionary periods and other periods where disposable income is adversely affected. A downturn in the economy affects retailers disproportionately, as consumers may prioritize reductions in discretionary spending, which could have a direct impact on purchases of our merchandise and adversely impact our results of operations. In addition, reduced consumer spending may drive us and our competitors to offer additional products at promotional prices, which would have a negative impact on gross profit.

**Disruption of global capital and credit markets may have a material adverse effect on the Company's liquidity and capital resources.**

Distress in the financial markets has in the past and can in the future result in extreme volatility in security prices, diminished liquidity and credit availability. There can be no assurance that our liquidity will not be affected by changes in the financial markets and the global economy or that our capital resources will at all times be sufficient to satisfy our liquidity needs.

**Historically, we have experienced declines and we may continue to experience fluctuation in our level of sales, results from operations and operating cash flow.**

A variety of factors has historically affected, and will continue to affect, our comparable stores sales results and profit margins. These factors include general regional and national economic conditions; competition; actions taken by our competitors; consumer trends and preferences; new product introductions and changes in our product mix; timing and effectiveness of promotional events and weather. The Company's comparable store sales may decline further than they did in Fiscal 2012. Also, they may vary from quarter to quarter as our business is highly seasonal in nature. Our highest sales and operating income historically occur during the fourth fiscal quarter, which is due in part, to the holiday selling season. The fourth quarter generated approximately 36% of our net sales for Fiscal 2012. Any decrease in our fourth quarter sales, whether due to a slow holiday selling season, unseasonable weather conditions, economic conditions or otherwise, could have a material adverse effect on our business, financial condition and operating results for the entire fiscal year. There is no assurance that we will achieve positive levels of sales and earnings growth, and any decline in our future growth or performance could have a material adverse effect on our business and results of operations.

**Failure to open new stores or renew existing leases in profitable stores may limit our earnings.**

Historically, the Company's growth has come from adding stores. The Company opens new stores if it finds desirable locations and is able to negotiate suitable lease terms for profitability. A lack of new store growth may impact the Company's ability to increase sales and earnings. The

Company opened one new store in Fiscal 2012. Likewise, the Company regularly renews leases at existing locations if those stores are profitable. Failure to renew these leases may impact the Company's earnings. See Item 2: Properties, for timing of lease expirations.

**A change in one or more of the Company's vendors' policies or the Company's relationship with those vendors could adversely affect the Company's results of operations.**

The Company is dependent on its vendors to supply merchandise in a timely and efficient manner. If a vendor fails to deliver on its commitments, whether due to financial difficulties or other reasons, the Company could experience merchandise shortages that could lead to lost sales.

The majority of the Company's purchases come from ten major suppliers. As is standard in its industry, the Company does not maintain long-term contracts with its suppliers but instead makes purchases on an order-by-order basis. If the Company fails to maintain customary trade terms or enjoy positive vendor relations, it could have an adverse effect on the Company's results of operations.

**If the Company's vendors fail to provide marketing and merchandising support at historical levels, the Company's results of operations could be adversely affected.**

The manufacturers of entertainment products have typically provided retailers with significant marketing and merchandising support for their products. As part of this support, the Company receives cooperative advertising and other allowances from these vendors. These allowances enable the Company to actively promote and merchandise the products it sells at its stores and on its websites. If the Company's vendors fail to provide this support at historical levels, the Company's results of operations could be negatively impacted.

**If we fail to protect the security of personal information about our customers, we could be subject to costly government enforcement actions or private litigation and our reputation could suffer.**

The nature of our business involves the receipt and storage of personal information about our customers. If we experience a data security breach, we could be exposed to government enforcement actions and private litigation. In addition, our customers could lose confidence in our ability to protect their personal information, which could cause them to stop shopping at our stores. Such events could lead to lost sales and adversely affect our results of operations.

**Loss of key personnel or the inability to attract, train and retain qualified employees could adversely affect the Company's results of operations.**

The Company believes that its future prospects depend, to a significant extent, on the services of its executive officers, particularly, Robert J. Higgins, our Chairman and Chief Executive Officer. Our future success will also depend on our ability to attract and retain qualified key personnel. The loss of the services of certain of the Company's executive officers and other key management personnel could adversely affect the Company's results of operations.

In addition to our executive officers, the Company's business is dependent on our ability to attract, train and retain a large number of qualified team members. Many of those team members are employed in entry-level or part-time positions with historically high turnover rates. Our ability to meet our labor needs while controlling our costs is subject to external factors such as unemployment levels, health care costs and changing demographics. If we are unable to attract and retain adequate numbers of qualified team members, our operations, customer service levels and support functions could suffer. Those factors, together with increased wage and benefit costs, could adversely affect our results of operations.

**Our Chairman and Chief Executive Officer owns approximately 45.9% of the outstanding Common Stock. Therefore, he has significant influence and control over the outcome of any vote of the Company's Shareholders.**

Robert J. Higgins serves as Chairman of the Board of the Company and its Chief Executive Officer and owns approximately 45.9% of the outstanding Common Stock of the Company, as of March 31, 2013 and there are no limitations on his acquiring shares in the future. Accordingly, Mr. Higgins has significant influence over the election of our directors, the appointment of new management and the opposition of actions requiring shareholder approval, such as adopting amendments to our articles of incorporation and approving mergers or sales of all or substantially all of our assets. Such concentration of ownership and substantial voting influence may have the effect of delaying or preventing a change of control, even if a change of control is in the best interest of all shareholders. There may be instances in which the interest of Mr. Higgins may conflict or be perceived as being in conflict with the interest of a holder of our securities or the interest of the company.

**Failure to comply with legal and regulatory requirements could adversely affect the Company's results of operations.**

The Company's business is subject to a wide array of laws and regulations. Significant legislative changes that impact our relationship with our workforce (none of which is represented by unions) could increase our expenses and adversely affect our operations. Examples of possible legislative changes impacting our relationship with our workforce include changes to an employer's obligation to recognize collective bargaining units, the process by which collective bargaining units are negotiated or imposed, minimum wage requirements, and health care mandates.

Our policies, procedures and internal controls are designed to comply with all applicable laws and regulations, including those imposed by the Securities and Exchange Commission and the NASDAQ Global Market, as well as applicable employment laws. Additional legal and regulatory requirements increase the complexity of the regulatory environment in which we operate and the related cost of compliance. Failure to comply with such laws and regulations may result in damage to our reputation, financial condition and market price of our stock.

**We could be materially and adversely affected if our distribution center is disrupted.**

We operate a distribution center in Albany, New York. We ship approximately 75% of our merchandise inventory through our distribution center. If our distribution center is destroyed or disrupted for any reason, including; weather, fire, labor, or other issues, we could incur significantly higher costs and longer lead times associated with distributing our products to our stores during the time it takes to reopen or replace the center.

We maintain business interruption insurance to protect us from the costs relating to matters such as a shutdown, but our insurance may not be sufficient, or the insurance proceeds may not be timely paid to us, in the event of a shutdown.

**The Company's stock price has experienced and could continue to experience volatility and could decline, resulting in a substantial loss on your investment.**

Our stock price has experienced, and could continue to experience in the future, substantial volatility as a result of many factors, including global economic conditions, broad market fluctuations and public perception of the prospects for music and the home video industry. Changes in our comparable store net sales could also affect the price of our Common Stock. Failure to meet market expectations, particularly with respect to comparable store sales, net revenues, operating margins and earnings per share, would likely result in a decline in the market price of our stock.

In addition, an active trading market for our Common Stock may not be sustained, which could affect the ability of our stockholders to sell their shares and could depress the market price of their shares. The stock market in general and the market for video and music related stocks in particular, has been highly volatile. For example, the closing price of our Common Stock at quarter ends has

fluctuated between \$1.62 and \$4.01 from January 31, 2011 to March 30, 2013. Investors in our Common Stock may experience a decrease in the value of their stock, including decreases unrelated to our operating performance or prospects.

**The failure to maintain a minimum closing share price of \$1.00 per share of our Common Stock could result in the delisting of our shares on The NASDAQ Global Market, which would harm the market price of the Company's Common Stock.**

In order to retain our listing on The NASDAQ Global Market we are required by NASDAQ to maintain a minimum bid price of \$1.00 per share. Our stock price is currently above \$1.00 and has been since October 6, 2009. However, in the event that our stock did close below the minimum bid price of \$1.00 per share for any 30 consecutive business days, we would regain compliance if our Common Stock closed at or above \$1.00 per share for 10 consecutive days during the 180 days immediately following failure to maintain the minimum bid price. If we are unable to do so, our stock could be delisted from The NASDAQ Global Market, transferred to a listing on The NASDAQ Capital Market, or delisted from the NASDAQ markets altogether. The failure to maintain our listing on The NASDAQ Global Market could harm the liquidity of the Company's Common Stock and could have an adverse effect on the market price of our Common Stock.

**Item 1B. UNRESOLVED SEC COMMENTS**

None.

**Item 2. PROPERTIES**

**Retail Stores**

As of February 2, 2013, the Company operated 358 stores under operating leases, some of which have renewal options. The majority of the leases provide for the payment of fixed monthly rentals and expenses for; maintenance, property taxes and insurance, while others provide for the payment of monthly rentals based on a percentage of sales. Certain leases provide for additional rent based on store sales in excess of specified levels. The following table lists the leases due to expire in each of the years shown as of the fiscal year-end, assuming any renewal options are not exercised:

<u>Year</u>	<u>No. of Leases</u>	<u>Year</u>	<u>No. of Leases</u>
2013	189	2017	14
2014	59	2018	4
2015	78	2019	1
2016	13		

As leases expire, the Company will evaluate the decision to exercise renewal rights or obtain new leases for the same or similar locations based on store profitability.

**Corporate Offices and Distribution Center Facility**

The Company leases its Albany, New York, distribution facility and corporate office space from its largest shareholder and Chairman and Chief Executive Officer under three capital lease arrangements that extend through 2015. These leases are at fixed rentals with provisions for biennial increases based on increases in the Consumer Price Index. The Company incurs all property taxes, insurance and maintenance costs. The office portion of the facility is approximately 39,800 square feet and the distribution center portion is approximately 141,500 square feet.

The Company believes that its existing distribution facility is adequate to meet the Company's planned business needs. Shipments from the distribution facility to the Company's stores provide approximately 75% of all merchandise shipment requirements to stores. Stores are serviced by common carriers chosen on the basis of geography and rate considerations. The balance of the stores' merchandise requirements is satisfied through direct shipments from vendors.

**Item 3. LEGAL PROCEEDINGS**

The Company is subject to various 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 or in the aggregate, will not have a material adverse effect on the results of operations and financial condition of the Company.

**Item 4. Mine Safety Disclosures**

None.

## PART II

### Item 5. MARKET FOR THE REGISTRANT’S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

**Market Information.** The Company’s Common Stock trades on the NASDAQ Stock Market under the symbol “TWMC.” As of March 30, 2013, there were 422 shareholders of record. The following table sets forth high and low last reported sale prices for each fiscal quarter during the period from February 1, 2011 through March 30, 2013.

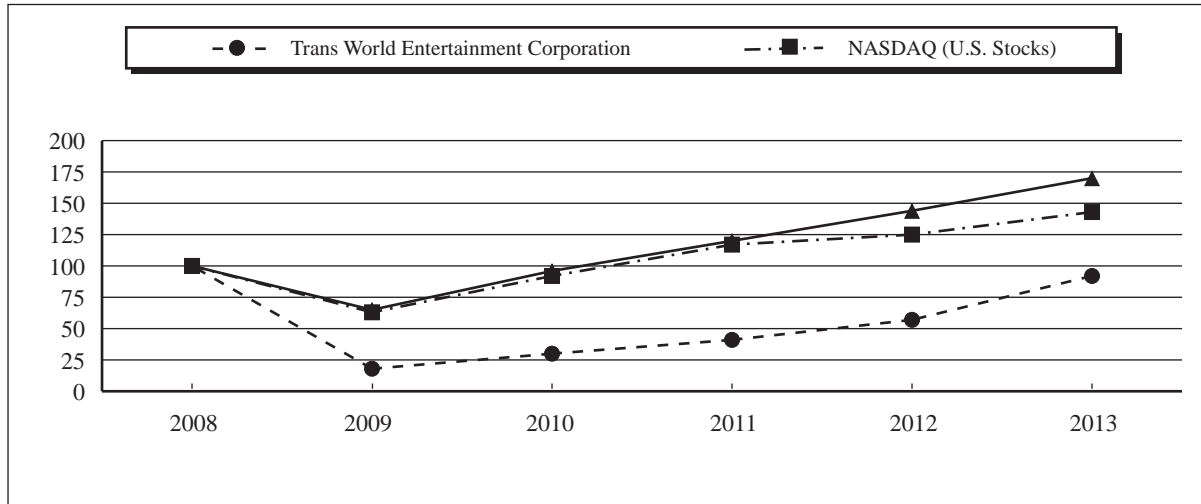
	Closing Sales Prices	
	High	Low
2011		
1st Quarter .....	\$1.94	\$1.62
2nd Quarter .....	\$2.11	\$1.64
3rd Quarter .....	\$2.22	\$1.77
4th Quarter .....	\$2.54	\$1.98
2012		
1st Quarter .....	\$2.50	\$2.12
2nd Quarter .....	\$3.10	\$2.20
3rd Quarter .....	\$3.99	\$3.00
4th Quarter .....	\$3.90	\$3.36
2013		
1st Quarter (through March 30, 2013) .....	\$4.01	\$3.36

On March 30, 2013, the last reported sale price on the Common Stock on the NASDAQ National Market was \$3.87.

**Dividend Policy:** In the fourth quarter of Fiscal 2012, the Company declared and paid a special cash dividend of \$0.47 per common share. This was a one-time special dividend and we cannot guarantee any future dividends. The declaration and payment of any future dividends will be at the sole discretion of the board of directors. We did not pay cash dividends in 2011. The Company’s amended credit facility contains certain restrictions related to the payment of cash dividends, including limiting the amount of dividends to \$5.0 million annually and not allowing borrowings under the amended facility for the six months before or six months after the dividend payment. On November 27, 2012, Wells Fargo Bank, National Association (the “Administrative Agent”) and certain other parties to the amended credit facility agreed to consent to the use of a portion of the proceeds received from the sale of real property owned by Record Town, Inc. to pay the special cash dividend.

**Five-Year Performance Graph:**

The following line graph reflects a comparison of the cumulative total return of the Company's Common Stock from January 31, 2008 through January 31, 2013 with the Nasdaq Index (U.S. Stocks) and with the Nasdaq National Market Retail Trade Stocks index. Because none of the Company's leading competitors has been an independent publicly traded company over the period, the Company has elected to compare shareholder returns with the published index of retail companies compiled by NASDAQ. All values assume a \$100 investment on January 31, 2008, and that all dividends were reinvested.



	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>
<b>Trans World Entertainment Corporation</b> .....	<b>100</b>	<b>18</b>	<b>30</b>	<b>41</b>	<b>57</b>	<b>92</b>
<b>NASDAQ (U.S. Stocks)</b> .....	<b>100</b>	<b>63</b>	<b>92</b>	<b>117</b>	<b>125</b>	<b>143</b>
<b>NASDAQ Retail Trade Stocks</b> .....	<b>100</b>	<b>65</b>	<b>96</b>	<b>120</b>	<b>144</b>	<b>170</b>

**Item 6. SELECTED CONSOLIDATED FINANCIAL DATA**

The following table sets forth selected Statement of Operations and Balance Sheet data for the five fiscal years ended February 2, 2013 and is derived from the Company’s audited Consolidated Financial Statements. The fiscal year ended February 2, 2013 consisted of 53 weeks while all the other fiscal years of the Company presented consisted of 52 weeks. This information should be read in conjunction with the Company’s audited Consolidated Financial Statements and related notes and other financial information included herein, including Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations”.

	Fiscal Year Ended				
	February 2, 2013	January 28, 2012	January 29, 2011	January 30, 2010	January 31, 2009
	(\$ in thousands, except per share data)				
<b>STATEMENTS OF OPERATIONS DATA:</b>					
Net sales .....	\$458,544	\$542,589	\$ 652,416	\$ 813,988	\$ 987,625
Cost of sales .....	<u>286,422</u>	<u>344,435</u>	<u>433,036</u>	<u>552,327</u>	<u>656,730</u>
Gross profit .....	172,122	198,154	219,380	261,661	330,895
Selling, general and administrative expenses .....	158,572	192,653	244,749	310,710	380,802
Gain on sale of asset .....	(22,750)	—	—	—	—
Asset impairment charges .....	—	—	1,973	3,643	15,158
Income (loss) from operations .....	36,300	5,501	(27,342)	(52,692)	(65,065)
Interest expense .....	2,384	3,429	3,557	2,910	4,098
Other income .....	(66)	(240)	(211)	(168)	(180)
Income (loss) before income taxes .....	33,982	2,312	(30,688)	(55,434)	(68,983)
Income tax expense (benefit) <sup>(1)</sup> .....	<u>248</u>	<u>150</u>	<u>275</u>	<u>(12,985)</u>	<u>(28)</u>
Net income (loss) .....	<u>\$ 33,734</u>	<u>\$ 2,162</u>	<u>(\$30,963)</u>	<u>(\$42,449)</u>	<u>(\$68,955)</u>
Basic earnings (loss) per share .....	<u>\$ 1.07</u>	<u>\$ 0.07</u>	<u>(\$0.99)</u>	<u>(\$1.35)</u>	<u>(\$2.21)</u>
Weighted average number of shares outstanding — basic .....	<u>31,577</u>	<u>31,520</u>	<u>31,417</u>	<u>31,370</u>	<u>31,223</u>
Diluted earnings (loss) per share .....	<u>\$ 1.06</u>	<u>\$ 0.07</u>	<u>(\$0.99)</u>	<u>(\$1.35)</u>	<u>(\$2.21)</u>
Weighted average number of shares — diluted .....	<u>31,878</u>	<u>32,036</u>	<u>31,417</u>	<u>31,370</u>	<u>31,223</u>
Cash dividend paid per share .....	\$ 0.47	—	—	—	—

	Fiscal Year Ended				
	February 2, 2013	January 28, 2012	January 29, 2011	January 30, 2010	January 31, 2009
	(\$ and square footage in thousands, except store count data)				
<b>BALANCE SHEET DATA (at the end of the period):</b>					
Total assets .....	\$315,240	\$313,120	\$348,724	\$394,566	\$487,036
Current portion of long-term debt and capital lease obligations .....	936	1,503	1,363	1,974	3,748
Long-term obligations .....	2,004	4,009	5,511	6,874	8,844
Shareholders’ equity .....	\$180,760	\$161,846	\$161,798	\$193,353	\$235,015

<b>OPERATING DATA:</b>					
<b>Store count (open at end of period):</b>					
Mall stores .....	304	324	376	449	549
Freestanding stores .....	54	66	84	108	163
Total stores .....	358	390	460	557	712
Comparable store sales decreases <sup>(1)</sup> .....	(1%)	(2%)	(4%)	(10%)	(11%)
Total square footage in operation (Year end) .....	2,209	2,562	3,149	3,794	4,560
Total square footage in operation (Average) .....	2,362	2,913	3,543	4,424	4,935

<sup>(1)</sup> A store is included in comparable store sales calculations at the beginning of its thirteenth full month of operation. Stores relocated, expanded or downsized are excluded from comparable store 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 sales through the month immediately preceding the month of closing.



## Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### Overview

Management's Discussion and Analysis of Financial Condition and Results of Operations provide information that the Company's management believes necessary to achieve an understanding of its financial condition 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 game 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 "Selected Consolidated Financial Data" and the Consolidated Financial Statements and related notes included elsewhere in this report.

As of February 2, 2013, the Company operated 358 stores totaling approximately 2.2 million square feet in the United States, the District of Columbia and the Commonwealth of Puerto Rico. In Fiscal 2012, the Company's net sales decreased as compared to Fiscal 2011 as a result of lower average store count and a decrease in comparable store sales. Comparable store sales decreased 1% during Fiscal 2012.

The U.S. entertainment retailing industry is a mature industry and has experienced declines in recent years. Physical Music and Video represent our primary product categories in terms of sales and both categories have been impacted by new distribution channels, including digital distribution and internet fulfillment. As a result, the Company has had negative comparable store sales for the past five years. To mitigate or lessen the impact these changes have had, the Company has focused on the following areas in an effort to improve its business:

#### *Improving Product Mix and Creating Value for our Customers*

The Company tailors the product mix of its stores toward regional tastes in order to optimize the productivity of its stores, seeking to serve key customer segments within each store. We have also focused on creating a stronger value statement for our customers in our two core categories of video and music to drive additional traffic into the stores and improve customer conversion rates, while offering products in other categories to drive additional sales and broaden our customer base. In Fiscal 2012, the trend and electronics categories represented in aggregate 21% of the Company's net sales and had an aggregate 11% comparable store sales increase as the Company continues to strengthen assortment in these categories.

#### *Store Portfolio Evaluation*

During Fiscal 2012 and Fiscal 2011, the Company closed 33 and 71 stores, respectively. The Company's real estate strategy is to maintain our core group of profitable locations, while evaluating opportunities for new locations. The Company opened one store in each of Fiscal 2012 and Fiscal 2011. The Company expects to open additional new stores in the future while continuing to reduce the number of store closings.

The Company closes stores when minimum operating thresholds are not achieved or upon lease expiration when either renewal is not available or management determines that renewal is not in the Company's best interest. The Company has signed short-term lease agreements for desirable locations, which enables us to negotiate rents that are responsive to the then-current sales environment. We will continue to close stores that do not meet our profitability goals, a process which could result in additional future asset impairments and store closure costs. Continued reduction in the number of stores would lower total sales and gross profit of the Company.

The Company believes that there is near-term opportunity in improving the productivity of existing stores. The environment in which our stores operate is intensely competitive and includes Internet-based retailers and mass merchants. We believe a specialty retailer that can differentiate itself by offering a distinctive customer experience, and that can operate efficiently, will be better positioned to maintain or grow market share. Therefore, we remain dedicated to the operational improvement of our stores and offering our customers a rewarding shopping experience.

### ***Expanding Customer Base***

To strengthen customer loyalty, the Company offers its customers the option of signing up for a Backstage Pass card which provides an additional 10% discount off of everyday selling prices on nearly all products in addition to other value added benefits members receive through the program in exchange for a membership fee. The Company also co-sponsors events in many of its stores to provide various segments of its customers an opportunity to experience entertainment and shop for unique and exclusive products based on their particular interests.

### **Key Performance Indicators**

Management monitors a number of key performance indicators to evaluate its performance, including:

**Net Sales and Comparable Store Sales:** The Company measures 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 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 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 calculated based on the cost of product in relation to its retail selling value. Changes in gross profit are impacted primarily by net sales levels, mix of products sold, vendor discounts and allowances and distribution costs. The Company records its distribution, freight and obsolescence expenses in cost of sales. Distribution expenses include those costs associated with receiving, inspecting and warehousing merchandise and costs associated with product returns to vendors.

**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 discussed in Note 2 of Notes to the Consolidated Financial Statements in this Annual Report on Form 10-K). SG&A expenses also include fixed assets write-offs associated with store closures, if any, and miscellaneous 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 indicators of its financial position. See Liquidity and Capital Resources for further discussion of these items.

### **Fiscal Year Ended February 2, 2013 (“Fiscal 2012”) Compared to Fiscal Year Ended January 29, 2012 (“Fiscal 2011”)**

**Net Sales.** The following table sets forth a year-over-year comparison of the Company’s total net sales:

	<u>2012</u>	<u>2011</u>	<u>2012 vs. 2011</u>	
			<u>\$</u>	<u>%</u>
			(\$ in thousands)	
Net Sales .....	\$458,544	\$542,589	(\$84,045)	(15.5%)

The 15.5% net sales decline from prior year is due to a 13.9% decline in average stores in operation and a 1% decline in comparable store net sales. Stores closed in fiscal 2011 and fiscal 2012 recorded sales of \$120 million in 2011. While the Company believes a meaningful amount of sales was transferred to ongoing stores, there was a reduction of sales from store closings. Total product units sold in Fiscal 2012 decreased 12.7% and the average retail price for units sold decreased 3.4%.

Net sales by merchandise category for Fiscal 2012 and Fiscal 2011 were as follows:

	<u>2012</u> <u>Net Sales</u>	<u>%</u> <u>Total</u>	<u>2011</u> <u>Net Sales</u>	<u>%</u> <u>Total</u>	<u>Total %</u> <u>Net Sales</u> <u>Change</u>	<u>Comparable</u> <u>Store % Net</u> <u>Sales Change</u>
	(\$ in thousands)					
Video .....	200,842	43.8%	\$229,256	42.3%	(12.4%)	4.0%
Music .....	141,690	30.9	185,305	34.2	(23.5)	(12.0)
Electronics .....	48,147	10.5	52,884	9.7	(9.0)	5.0
Trend .....	46,313	10.1	46,690	8.6	(0.8)	17.0
Video games .....	<u>21,552</u>	<u>4.7</u>	<u>28,454</u>	<u>5.2</u>	<u>(24.3)</u>	<u>(15.0)</u>
Total .....	<u>\$458,544</u>	<u>100.0%</u>	<u>\$542,589</u>	<u>100.0%</u>	<u>(15.5%)</u>	<u>(1.0%)</u>

### *Video*

The Company's stores offer a wide range of new and used DVDs and Blu-rays in a majority of its stores. Total net sales for Fiscal 2012 in the video category decreased 12.4% due to the lower average store count, partially offset by a 4% increase in comparable store sales. The video category increased as a percentage of the Company's total net sales due to a comparable store sales increase compared to the total Company comparable store sales decline.

According to Warner Home Video, total video sales in the United States declined 5% during the period Fiscal 2012.

### *Music*

The Company's stores offer a wide range of new and used CDs and music DVDs across most music genres, including new releases from current artists as well as an extensive catalog of music from past periods and artists. Total net sales in the music category declined 12% on a comparable store sale basis in Fiscal 2012.

Net sales of CDs represented approximately 95% of total net sales in the music category during Fiscal 2012. The Company's annual CD unit sales decreased 23% in Fiscal 2012 due to the decrease in average store count and lower comparable store net sales. According to SoundScan, total CD unit sales in the United States declined 14% during the period corresponding with the Company's Fiscal 2012 due primarily to a lack of hit product compared to the prior year.

### *Electronics*

The Company's stores offer a selection of complementary portable electronics and accessories to support our entertainment products. Total net sales in the electronics category increased 5% on a comparable store sales basis. During Fiscal 2012, the Company expanded its assortment and selection in the electronics category. Electronics represented 10.5% of the Company's total net sales in Fiscal 2012 versus 9.7% in Fiscal 2011.

### *Trend*

The Company's stores offer a selection of trend and apparel products that relate to theatrical releases, music, and gaming. The trend category increased 17% on a comparable store sales basis. Trend represented 10.1% of the Company's total net sales in Fiscal 2012 versus 8.6% in Fiscal 2011.

### Video games

During Fiscal 2012, the Company offered video games in approximately 100 stores. Comparable net sales in the games category declined 15%.

According to NPD, industry wide video games sales were down 22% during the period corresponding with the Company's Fiscal 2012.

**Gross Profit.** The following table sets forth a year-over-year comparison of the Company's Gross Profit:

	2012	2011	2012 vs. 2011	
			\$	%
			(\$ in thousands)	
Gross Profit .....	\$172,122	\$198,154	(\$26,032)	(13.1%)
As a percentage of net sales.....	37.5%	36.5%		

Gross margin improved 100 basis points due to higher gross margin across all product categories attributable to improved inventory management.

**Selling, General and Administrative Expenses.** The following table sets forth a year-over-year comparison of the Company's SG&A expenses:

	2012	2011	2012 vs. 2011	
			\$	%
			(\$ in thousands)	
Selling, general and administrative expenses.....	\$158,572	\$192,653	(\$34,081)	(17.7%)
As a percentage of net sales.....	34.6%	35.5%		

The \$34 million decrease in SG&A expenses is due to a \$30 million reduction in store expenses arising from the Company operating an average of 13.9% fewer stores and lower operating expenses in the ongoing stores, as well as a \$4 million reduction in corporate overhead expenses. SG&A as a percentage of net sales decreased 90 basis points from 35.5% in 2011 to 34.6% in 2012.

**Gain on Sale of Asset.** The Gain on Sale of Asset in Fiscal 2012 of \$22.8 million was due to the sale of real property in Miami, Florida. See Note 3, "Gain on Sale of Asset" in the Notes to the Consolidated Financial Statements for further discussion of the sale. We did not sell any assets during fiscal 2011.

**Interest Expense.** Interest expense in Fiscal 2012 was \$2.4 million compared to \$3.4 million in Fiscal 2011. The reduction in interest expense was due to lower costs associated with the Second Amended Credit Facility as compared to the Amended Credit Facility.

**Other Income.** Other income, which includes interest income, was \$66,000 in Fiscal 2012 compared to \$240,000 in Fiscal 2011.

**Income Tax Expense.** The following table sets forth a year-over-year comparison of the Company's income tax expense:

	2012	2011	2012 vs. 2011	
			\$	%
			(\$ in thousands)	
Income tax expense.....	\$248	\$150	\$98	
Effective tax rate .....	0.7%	6.5%		

The Fiscal 2012 and 2011 income tax expense includes state taxes, adjustments to the reserve for uncertain tax positions and the accrual of interest. See Note 6 in the Notes to Consolidated Financial Statements for further detail.

**Net income.** The following table sets forth a year-over-year comparison of the Company's net income:

	<u>2012</u>	<u>2011</u>	<u>2012 vs. 2011</u>
		(\$ in thousands)	\$
Net income.....	\$33,734	\$2,162	\$31,572
Net income as a percentage of net sales .....	7.4%	0.4%	

Net income for Fiscal 2012 increased by \$31.5 million to \$33.7 million, as compared to \$2.2 million for Fiscal 2011, primarily due to the \$22.8 million gain on the sale of assets, increased gross margin and a reduction in SG&A expenses.

**Fiscal Year Ended January 28, 2012 ("Fiscal 2011")  
Compared to Fiscal Year Ended January 29, 2011 ("Fiscal 2010")**

**Net Sales.** The following table sets forth a year-over-year comparison of the Company's total net sales:

	<u>2011</u>	<u>2010</u>	<u>2011 vs. 2010</u>	
		(\$ in thousands)	\$	%
Net Sales.....	\$542,589	\$652,416	(\$109,827)	(16.8%)

The 16.8% net sales decline from prior year is due to a 17.5% decline in store count and a 2% decline in comparable store net sales. Stores closed in fiscal 2010 and fiscal 2011 recorded sales of \$162 million in 2010. While the Company believes a meaningful amount of sales was transferred to ongoing stores, there was a reduction of sales from store closings. Total product units sold in Fiscal 2011 decreased 14.8% and the average retail price for units sold decreased 3.2%.

Net sales by merchandise category for Fiscal 2011 and Fiscal 2010 were as follows:

	<u>2011</u>	<u>%</u>	<u>2010</u>	<u>%</u>	<u>Total %</u>	<u>Comparable</u>
	Net Sales	Total	Net Sales	Total	Net Sales	Store % Net
	(\$ in thousands)					
Video .....	\$229,256	42.3%	\$284,711	43.7%	(19.5%)	(4%)
Music .....	185,305	34.2	231,721	35.5	(20.0%)	(8%)
Electronics.....	52,884	9.7	51,632	7.9	2.4%	17%
Trend .....	46,690	8.6	47,062	7.2	(0.8%)	18%
Video games .....	28,454	5.2	37,290	5.7	(23.7%)	(11%)
Total .....	<u>\$542,589</u>	<u>100.0%</u>	<u>\$652,416</u>	<u>100.0%</u>	<u>(16.8%)</u>	<u>(2%)</u>

**Video**

The Company's stores offer a wide range of new and used DVDs and Blu-rays in a majority of its stores. The video category decreased as a percentage of the Company's total net sales due to a larger comparable store sales decline compared to the total Company comparable store sales decline.

Total net sales for Fiscal 2011 in the video category decreased 19.5% due to the lower average store count and a 4% decline in comparable store sales. According to Warner Home Video, total video unit sales in the United States declined 7% during the period corresponding with the Company's Fiscal 2011.

**Music**

The Company's stores offer a wide range of new and used CDs and music DVDs across most music genres, including new releases from current artists as well as an extensive catalog of music from past periods and artists. Total net sales in the music category declined 8% on a comparable store sale basis in Fiscal 2011.

Net sales of CDs represented approximately 95% of total net sales in the music category during Fiscal 2011. The Company's annual CD unit sales decreased 20% in Fiscal 2011 due to the decrease in average store count and lower comparable store net sales. According to SoundScan, total CD unit sales in the United States declined 5% during the period corresponding with the Company's Fiscal 2011.

### **Electronics**

The Company's stores offer a selection of complementary electronics products to support our entertainment products. Total net sales in the electronics category increased 17% on a comparable store sales basis. During Fiscal 2011, the Company expanded its assortment and selection in the electronics category. Electronics represented 9.7% of the Company's total net sales in Fiscal 2011 versus 7.9% in Fiscal 2010.

### **Trend**

The Company's stores offer a selection of trend products that relate to theatrical releases, music, and gaming. The trend category increased 18% on a comparable store sales basis. Trend represented 8.6% of the Company's total net sales in Fiscal 2011 versus 7.2% in Fiscal 2010.

### **Video games**

During Fiscal 2011, the Company offered video games in 110 stores. The negative comparable store sales in video games were consistent with industry declines. According to NPD, industry wide video games sales were down 10% during the period corresponding with the Company's Fiscal 2011.

**Gross Profit.** The following table sets forth a year-over-year comparison of the Company's Gross Profit:

	<u>2011</u>	<u>2010</u>	<u>2011 vs. 2010</u>	
			<u>\$</u>	<u>%</u>
			(\$ in thousands)	
Gross Profit.....	\$198,154	\$219,380	(\$21,226)	(9.7%)
As a percentage of net sales.....	36.5%	33.6%		

Gross margin improved 290 basis points due to higher gross margin across all product categories and the leveraging of distribution and freight expenses.

**Selling, General and Administrative Expenses.** The following table sets forth a year-over-year comparison of the Company's SG&A expenses:

	<u>2011</u>	<u>2010</u>	<u>2011 vs. 2010</u>	
			<u>\$</u>	<u>%</u>
			(\$ in thousands)	
Selling, general and administrative expenses.....	\$192,653	\$244,749	(\$52,096)	(21.3%)
As a percentage of net sales.....	35.5%	37.5%		

The \$52 million decrease in SG&A expenses is due to a \$45 million reduction in store expenses arising from the Company operating an average of 17.5% fewer stores and lower operating expenses in the ongoing stores, as well as a \$4 million reduction in corporate overhead expenses. SG&A as a percentage of net sales decreased 200 basis points from 37.5% in 2010 to 35.5% in 2011.

**Asset Impairment Charge.** During Fiscal 2011, there were no events or circumstances that indicated to management that the carrying amount of any long-lived assets may not be recoverable. Therefore, no impairment testing was performed. During Fiscal 2010, the Company concluded, based on a significant decline in sales and earnings during the fourth quarter, that triggering events had occurred requiring a test of long-lived assets for impairment at its retail stores and consolidated subsidiaries. Long-lived assets at locations where impairment was determined to exist were written down to their estimated fair values as of the end of the period resulting in the recording of asset impairment charges of \$2.0 million in Fiscal 2010. Estimated fair values for long-lived assets at these

locations, including store fixtures and equipment and leasehold improvements, were determined based on a measure of discounted future cash flows over the remaining lease terms at the respective locations. Future cash flows were estimated based on store plans and were discounted at a rate approximating the Company's cost of capital. Management believes its assumptions were reasonable and consistently applied.

**Interest Expense.** Interest expense in Fiscal 2011 was \$3.4 million compared to \$3.6 million in Fiscal 2010.

**Other Income.** Other income, which includes interest income, was \$240,000 in Fiscal 2011 compared to \$211,000 in Fiscal 2010.

**Income Tax Expense.** The following table sets forth a year-over-year comparison of the Company's income tax expense:

	<u>2011</u>	<u>2010</u>	<u>2011 vs. 2010</u>
		(\$ in thousands)	\$
Income tax expense.....	\$150	\$275	(\$125)
Effective tax rate .....	6.5%	0.9%	

The Fiscal 2011 and 2010 income tax expense includes state taxes, adjustments to the reserve for uncertain tax positions and the accrual of interest.

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

	<u>2011</u>	<u>2010</u>	<u>2011 vs. 2010</u>
		(\$ in thousands)	\$
Net income (loss) .....	\$2,162	(\$30,963)	\$33,125
Net income (loss) as a percentage of net sales .....	0.4%	(4.7%)	

Net income for Fiscal 2011 increased by \$33.1 million to \$2.2 million, as compared to a net loss of \$31.0 million for Fiscal 2010, primarily due to increased gross margin and a reduction in SG&A expenses.

## LIQUIDITY AND CAPITAL RESOURCES

**Liquidity and Cash Flows:** The Company's primary sources of working capital are cash provided by operations and borrowing capacity under its revolving credit facility. 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, the related terms on the purchases and capital expenditures. Management believes it will have adequate resources to fund its cash needs for the foreseeable future, including its capital spending, its seasonal increase in merchandise inventory and other operating cash requirements and commitments. Management continued many of the initiatives begun in 2011, as part of the execution of its operating plan for 2012; including a focus on the operation of a core base of stores, improved product selection based on customer preferences and industry changes, as well as further streamlining of its operations. During Fiscal 2012, management carried out certain strategic initiatives in its efforts to reduce certain operating costs. In addition, management closed 33 stores and plans to continue its evaluation of profitability of the Company's stores in consideration of lease terms, conditions and expirations, including considering new and relocated stores.

Management anticipates any cash requirements due to a shortfall in cash from operations will be funded by the Company's revolving credit facility, discussed hereafter. Cash flows from investing activities are expected to be comprised primarily of capital expenditures during fiscal 2013. Cash flows from financing activities are expected to be comprised primarily of payments on capital leases during Fiscal 2013. 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 three year summary of key components of cash flow and working capital:

	<u>2012</u>	<u>2011</u>	<u>2012 vs. 2011</u>	<u>2010</u>	<u>2011 vs. 2010</u>
	(\$ in thousands)				
Operating Cash Flows .....	\$ 35,633	\$ 16,771	\$ 18,862	\$ 10,464	\$ 6,307
Investing Cash Flows .....	25,706	(2,105)	27,811	(4,792)	2,687
Financing Cash Flows.....	(16,872)	(1,363)	15,509	(1,974)	612
Capital Expenditures.....	(3,351)	(2,105)	(1,246)	(2,944)	839
End of Period Balances:					
Cash and Cash Equivalents .....	132,982	88,515	44,467	75,212	13,303
Merchandise Inventory .....	155,429	191,327	(35,898)	234,164	(42,831)
Working Capital .....	189,149	164,295	24,854	158,366	5,929
Inventory turns .....	1.6	1.6		1.7	

During Fiscal 2012, cash flow from operations was \$35.6 million primarily due to a \$35.9 million decrease in merchandise inventory and net income of \$11.0 million (excluding the impact of the one-time gain from the sales of real property) offset by a \$13.7 million reduction in accounts payable. During Fiscal 2011, cash flow from operations was \$16.8 million primarily due to a \$42.8 million decrease in merchandise inventory and net income of \$2.2 million offset by a \$36.9 million reduction in accounts payable.

The Company monitors various statistics to measure its management of inventory, including inventory turn (annual cost of sales divided by average merchandise inventory balances), inventory investment per square foot (merchandise inventory divided by total store square footage) and inventory leverage (accounts payable divided by merchandise inventory). Inventory turnover measures the Company's ability to sell merchandise and how many times it is replaced in a year. This ratio is important in determining the need for markdowns and planning future inventory levels and assessing customer response to our merchandise. Inventory turn in Fiscal 2012 was 1.6 the same level as Fiscal 2011. Inventory investment per square foot measures the productivity of the inventory. It is important in determining if the Company has the appropriate level of inventory to meet customer demands while controlling its investment in inventory. Inventory investment per square foot was \$70 per square foot at the end of Fiscal 2012 as compared to \$75 per square foot at the end of Fiscal 2011. Accounts payable leverage measures the percentage of inventory being funded by the Company's product vendors. The percentage is important in determining the Company's ability to fund its business. Accounts payable leverage on inventory was 51% as of February 2, 2013 compared with 49% as of January 28, 2012.

Cash provided by investing activities was \$25.7 million in Fiscal 2012, compared to cash flows used by investing activities of \$2.1 million in Fiscal 2011. During Fiscal 2012, cash provided by investing activities consisted of proceeds from the sale of real property of \$29.1 million, partially offset by capital expenditures of \$3.4 million. During Fiscal 2011, cash used in investing activities consisted of capital expenditures of \$2.1 million. The Company's capital expenditures in Fiscal 2012 consisted primarily of the expenditures for store improvements and investments in information technology improvements.

The Company has historically financed its capital expenditures through borrowings under its credit facility, select financing arrangements and cash flow from operations. The Company anticipates capital spending of approximately \$10.0 million in Fiscal 2013 as the Company invests in strategic initiatives, including investments in our store base.

Cash used in financing activities was \$16.9 million in Fiscal 2012, compared to \$1.4 million in Fiscal 2011. In Fiscal 2012, the primary uses of cash were payment of a special dividend of \$14.9 million and payments of long-term debt and capital lease obligations of \$1.7 million and \$824,000, respectively. During Fiscal 2012, the Company paid off the remaining obligation of \$1.7 million related to a mortgage loan on real estate. In Fiscal 2011, the primary uses of cash were payments of long-term debt and capital lease obligations of \$640,000 and \$723,000, respectively.



In May 2012, the Company entered into a \$75 million credit facility (“Second Amended Credit Facility”) which amended its previous \$100 million credit facility (“Amended Credit Facility”). As part of the amendment, the Administrative Agent, Collateral Agent, Swingline Lender and Issuing Bank was transferred from Bank of America to Wells Fargo. The principal amount of all outstanding loans under the Second Amended 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 Second Amended Credit Facility. Payments of amounts due under the Second Amended Credit Facility are secured by the assets of the Company.

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

Interest under the Second Amended 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 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 Second Amended Credit Facility is subject to limitations based on sufficient inventory levels. See Note 5 in the Notes to Consolidated Financial Statements for further detail.

As of February 2, 2013, the Company did not have any borrowings and had \$0.4 million in outstanding letter of credit obligations under the Second Amended Credit Facility with Wells Fargo. During Fiscal 2012 and Fiscal 2011, the Company did not have any borrowings under the Second Amended Credit Facility or Amended Credit Facility. As of January 28, 2012, the Company did not have any borrowings and had \$0.3 million in outstanding letter of credit obligations under the Amended Credit Facility with Bank of America, N.A. The Company had \$54 million and \$69 million available for borrowing as of February 2, 2013 and January 28, 2012, respectively. Interest expense in Fiscal 2012 was \$2.4 million, of which \$1.4 million was incurred for capital leases. Interest expense in Fiscal 2011 was \$3.4 million, of which \$1.4 million was incurred for capital leases.

**Off Balance Sheet Arrangements.** The Company has no off balance sheet arrangements as defined by Item 303 (a) (4) of Regulation S-K.

**Contractual Obligations and Commitments.** The following table summarizes the Company’s contractual obligations as of February 2, 2013, and the effect that such obligations are expected to have on liquidity and cash flows in future periods.

<u>Contractual Obligation</u>	<u>2013</u>	<u>2014-2015</u>	<u>2016-2017</u>	<u>2018 and Beyond</u>	<u>Total</u>
	(\$ in thousands)				
Operating lease and maintenance agreement obligations .....	31,053	26,186	6,754	1,228	65,221
Capital lease obligations .....	2,251	3,974	—	—	6,225
Purchase obligations <sup>(1)</sup> .....	—	—	—	—	—
Other long-term liabilities <sup>(2)</sup> .....	1,506	1,065	210	42	2,823
Pension benefits <sup>(3)</sup> .....	151	1,326	2,179	6,031	9,687
Total .....	<u>34,961</u>	<u>32,551</u>	<u>9,143</u>	<u>7,301</u>	<u>83,956</u>

<sup>(1)</sup> For the purposes of this table, contractual obligations for purchase of goods or services are defined as agreements that are enforceable and legally binding and that specify all significant terms, including: fixed or minimum quantities to be purchased; fixed, minimum or variable price

provisions; and the approximate timing of the transaction. The Company's purchase orders are based on its current inventory needs and are fulfilled by its suppliers within short time periods.

- (2) Included in other long-term liabilities in the Consolidated Balance Sheet as of February 2, 2013 is the long-term portion of deferred rent of \$0.6 million which are not reflected in the table above as these amounts do not represent contractual obligations. Also included in other long-term liabilities is the long-term portion of the straight line rent liability of \$0.5 million, which is included in operating lease obligations in the table above.

Included in other long-term liabilities in the table above are the estimated asset retirement obligations associated with the fixed assets and leasehold improvements at the Company's store locations that arise under the terms of operating leases.

- (3) In addition to the scheduled pension benefit payments, the Company offers a 401(k) Savings Plan to eligible employees (see also Note 8 of Notes to Consolidated Financial Statements in this Annual Report on Form 10-K). Total expense related to the Company's matching contribution was approximately \$0, \$3,000 and \$439,000 in Fiscal 2012, Fiscal 2011 and Fiscal 2010 respectively. The Company postponed its matching contribution effective March 1, 2011. Effective May 1, 2013, the Company will reinstate its matching contribution.

### **Related Party Transactions.**

The Company leases its 181,300 square foot distribution center/office facility in Albany, New York from Robert J. Higgins, its Chairman, Chief Executive Officer and largest shareholder, under three capital leases that expire in the year 2015. The original distribution center/office facility was occupied in 1985.

Under the three capital leases, dated April 1, 1985, November 1, 1989 and September 1, 1998, the Company paid Mr. Higgins an annual rent of \$2.3 million, \$2.2 million and \$2.2 million in Fiscal 2012, 2011 and 2010 respectively. Pursuant to the terms of the lease agreements, effective January 1, 2002 and every two years thereafter, rental payments will increase in accordance with the biennial increase in the Consumer Price Index. Under the terms of the lease agreements, the Company is responsible for property taxes, insurance and other operating costs with respect to the premises. During 2010, Mr. Higgins paid \$0.8 million for principal and interest on his underlying indebtedness relating to the real property. Mr. Higgins does not have any future obligation for principal and interest. None of the leases contain any real property purchase options at the expiration of its term.

The Company leases one of its retail stores from Mr. Higgins under an operating lease. Annual rental payments under this lease were \$40,000 in Fiscal 2012, 2011 and 2010. Under the terms of the lease, the Company pays property taxes, maintenance and a contingent rental if a specified sales level is achieved. No contingent rental was paid in Fiscal 2012, 2011, and 2010. Total additional charges for the store were approximately \$6,400, \$6,900 and \$6,800 in Fiscal 2012, 2011 and 2010 respectively.

### **CRITICAL ACCOUNTING POLICIES**

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, valuation of long-lived assets, 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. Note 1 of the Notes to Consolidated Financial Statements in this Annual Report on Form 10-K includes a summary of the significant accounting policies and methods used by the Company in the preparation of its consolidated financial statements. Management believes that of the Company's significant accounting policies, the following may involve a higher degree of judgment or complexity:

**Merchandise Inventory and Return Costs:** Merchandise inventory is stated at the lower of cost or market under the average cost method. The average cost method attaches a cost to each item and is a blended average of the original purchase price and those of subsequent purchases or other cost adjustments throughout the life cycle of that item.

Inventory valuation requires significant judgment and estimates, including obsolescence, shrink and any adjustments to market value; if market value is lower than cost. Inherent in the entertainment products industry is the risk of obsolete inventory. Typically, newer releases generate a higher product demand. Some vendors offer credits to reduce the cost of products that are selling more slowly, thus allowing for a reduction in the selling price and reducing the possibility for items to become obsolete. The Company records obsolescence and any adjustments to market value (if lower than cost) based on current and anticipated demand, customer preferences, and market conditions. The provision for inventory shrink is estimated as a percentage of sales for the period from the last date a physical inventory was performed to the end of the fiscal year. Such estimates are based on historical results and trends and the shrink results from the last physical inventory. Physical inventories are taken at least annually for all stores and the distribution center throughout the year and inventory records are adjusted accordingly.

Shrink expense, including obsolescence was \$6.6 million, \$5.8 million and \$5.8 million, in Fiscal 2012, 2011 and 2010 respectively. As a rate to net sales, this equaled 1.4%, 1.1% and 1.2%, respectively. Presently, a 0.1% change in the rate of shrink provision would equal approximately \$0.3 million in additional charge or benefit to cost of sales, based on Fiscal 2012 net sales since the last physical inventories.

The Company is generally entitled to return merchandise purchased from major vendors for credit against other purchases from these vendors. Certain vendors reduce the credit with a per unit merchandise return charge which varies depending on the type of merchandise being returned. Certain other vendors charge a handling fee based on units returned. The Company records merchandise return charges in cost of sales. The Company incurred merchandise return charges in its Fiscal 2012, Fiscal 2011 and Fiscal 2010 of \$1.4 million, \$1.7 million and \$1.9 million, respectively.

**Valuation of Long-Lived Assets:** The Company assesses the impairment of long-lived assets to determine if any part of the carrying value may not be recoverable. Factors that the Company considers to be important when assessing impairment include:

- significant underperformance relative to historical or projected future operating results;
- significant changes in the manner of the use of acquired assets or the strategy for the Company's overall business;
- significant negative industry or economic trends;

If the Company determines that the carrying value of a long-lived asset may not be recoverable, it tests for impairment to determine if an impairment charge is needed. For the purpose of the asset impairment test, the Company has two asset groupings—corporate and store level assets. The Company did not record an asset impairment charge during Fiscal 2012 and Fiscal 2011. During Fiscal 2010, the Company recorded an asset impairment charge of \$2.0 million, related to the write down of certain long-lived assets at underperforming locations. Losses for store closings in the ordinary course of business represent the write down of the net book value of abandoned fixtures and leasehold improvements. The loss on disposal of fixed assets related to store closings was \$0.2 million, \$0.3 million and \$1.2 million in Fiscal 2012, 2011 and 2010, respectively, and is included in SG&A expenses in the Consolidated Statement of Operations and loss on disposal of fixed assets in the Consolidated Statement of Cash Flows. Store closings usually occur at the expiration of the lease, at which time leasehold improvements, which constitute a majority of the assets, are fully depreciated. There was no impairment of corporate level assets in Fiscal 2012, Fiscal 2011 and Fiscal 2010.

**Income Taxes:** Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and tax operating loss carryforwards. Deferred tax assets and liabilities are

measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the results of operations in the period that includes the enactment date.

Accounting for income taxes requires management to make estimates and judgments regarding interpretation of various taxing jurisdictions, laws and regulations as well as the ultimate realization of deferred tax assets. These estimates and judgments include the generation of future taxable income, viable tax planning strategies and support of tax filings. In assessing the value 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 upon 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 the available objective evidence, management concluded that a full valuation allowance should be recorded against its net deferred tax assets as of February 2, 2013. During Fiscal 2013 and in future years, the Company will continue to record a valuation allowance against recorded net deferred tax assets at a level deemed appropriate by management.

**Accounting for Gift Card Liability:** The Company sells gift cards that are redeemable only for merchandise and have no expiration date. The Company adjusts card liability when either customers redeem cards, at which point the Company records revenue, or when the Company determines it does not have a legal obligation to remit unredeemed cards to the relevant jurisdictions and the likelihood of the cards being redeemed becomes remote, at which point the Company records breakage as a credit to SG&A expenses. The Company's accounting for gift cards is based on estimating the Company's liability for future card redemptions at the end of a reporting period. Estimated liability is equal to the most recent two years of unredeemed cards, plus an amount for outstanding cards that may possibly be redeemed for the cumulative look-back period, exclusive of the last two years. The Company's ability to reasonably and reliably estimate the liability is based on historical redemption experience with gift cards and similar types of arrangements and the existence of a large volume of relatively homogeneous transactions. The Company's estimate is not susceptible to significant external factors and the circumstances around gift card sales and redemptions have not changed significantly over time.

#### **Recently Issued Accounting Pronouncements.**

Effective June 16, 2011, the Financial Accounting Standards Board ("FASB") issued ASU No. 2011-05, Comprehensive Income, requiring entities to report components of other comprehensive income in either a single continuous statement or in two separate but consecutive statements of net income and other comprehensive income. This ASU does not change the items that must be reported in comprehensive income, how these items are measured, or when these items must be classified to net income. Effective with the first quarter of 2012, we have provided herein the required financial reporting presentation pursuant to ASU 2011-05.

On February 5, 2013, the FASB issued ASU No. 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income, which adds additional disclosure requirements relating to the reclassification of items out of accumulated other comprehensive income. This ASU is effective for the first quarter of 2013.

There are no other recently issued accounting standards that are expected to have a material effect on our financial condition, results of operations or cash flows.

#### **Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The Company does not hold any financial instruments that expose it to significant market risk and does not engage in hedging activities. To the extent the Company borrows under its revolving 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. If interest rates on the Company's revolving 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. Information about the fair value of financial instruments is included in Note 1 of Notes to the Consolidated Financial Statements in this Annual Report on Form 10-K.

#### **Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

The index to the Company's Consolidated Financial Statements is included in Item 15, and the Consolidated Financial Statements follow the signature page to this Annual Report on Form 10-K and are incorporated herein by reference.

The quarterly results of operations are included herein in Note 11 of Notes to the Consolidated Financial Statements in this Annual Report on Form 10-K.

#### **Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

#### **Item 9A. CONTROLS AND PROCEDURES**

**Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures:** Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the Exchange Act). Based on this evaluation, our principal executive officer and our principal financial officer concluded that the Company's disclosure controls and procedures were designed to provide reasonable assurance of achieving their objectives and as of the end of the period covered by this annual report, our disclosure controls and procedures were effective, in that they provide reasonable assurance that information required to be disclosed by us in the reports we file or submit, under the Exchange Act, is recorded, processed, summarized, as appropriate, to allow timely decisions regarding required disclosure and reported within the time period specified in the Securities and Exchange Commission's rules and forms and that such information is accumulated and communicated to management including the principal executive officer and principal financial officer.

**Management's Report on Internal Control Over Financial Reporting:** Management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended). Under the supervision and with the participation of the Company's management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in *Internal Control-Integrated Framework*. Based on our evaluation under the framework in *Internal Control- Integrated Framework*, our management concluded that our internal control over financial reporting was effective as of February 2, 2013.

**Changes in Controls and Procedures:** No change in our internal control over financial reporting occurred during the quarterly period ended February 2, 2013 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

#### **Item 9B. Other Information**

No events have occurred which would require disclosure under this Item.

### **PART III**

#### **Item 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

(a) Identification of Directors

Incorporated herein by reference is the information appearing under the captions “Election of Directors” and “Compensation of Directors” in the Company’s definitive Proxy Statement for the Registrant’s 2013 Annual Meeting of Shareholders to be filed with the Securities and Exchange Commission within 120 days after February 2, 2013.

(b) Identification of Executive Officers

Incorporated herein by reference is the information appearing under the caption “Executive Compensation” in the Company’s definitive Proxy Statement for the Registrant’s 2013 Annual Meeting of Shareholders to be filed with the Securities and Exchange Commission within 120 days after February 2, 2013.

(c) Code of Ethics

We have adopted the Trans World Entertainment Corporation Code of Ethics that applies to all officers, directors, employees and consultants of the Company. The Code of Ethics is intended to comply with Item 406 of Regulation S-K of the Securities Exchange Act of 1934 and with applicable rules of The NASDAQ Stock Market, Inc. Our Code of Ethics is posted on our Internet website under the “Corporate” page. Our Internet website address is [www.twec.com](http://www.twec.com). To the extent required or permitted by the rules of the SEC and NASDAQ, we will disclose amendments and waivers relating to our Code of Ethics in the same place as our website.

### Item 11. EXECUTIVE COMPENSATION

Incorporated herein by reference is the information appearing under the caption “Report of the Compensation Committee” in the Company’s definitive Proxy Statement for the Registrant’s 2013 Annual Meeting of Shareholders to be filed with the Securities and Exchange Commission within 120 days after February 2, 2013.

### Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED SHAREHOLDER MATTERS

Incorporated herein by reference is the information appearing under the captions “Report of the Compensation Committee” and “Principal Shareholders” in the Company’s definitive Proxy Statement for the Registrant’s 2013 Annual Meeting of Shareholders to be filed with the Securities and Exchange Commission within 120 days after February 2, 2013.

Information on Trans World Entertainment Common Stock authorized for issuance under equity compensation plans is contained in our Proxy Statement for our 2013 Annual Meeting of Shareholders under the caption “Report of the Compensation Committee” and is incorporated herein by reference. See Note 8 of Notes to the Consolidated Financial Statements in this Annual Report on Form 10-K for a description of the Company’s employee stock award plans.

The following table contains information about the Company’s Common Stock that may be issued, as new shares, upon the exercise of options, warrants and rights under all of the Company’s equity compensation plans as of February 2, 2013:

<u>Plan Category</u>	<u>Number of Shares to be Issued upon Exercise of Outstanding Options, Warrants and Rights<sup>(1)</sup></u>	<u>Weighted Average Exercise Price of Outstanding Options, Warrants and Rights<sup>(1)</sup></u>	<u>Number of Shares Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Outstanding Options, Warrants and Rights)</u>
Equity Compensation Plan Approved by Shareholders.....	4,756, 946	\$6.33	2,589,820
Equity Compensation Plans and Agreements not Approved by Shareholders.....	—	—	—

<sup>(1)</sup> Includes 93,037 deferred shares under which shares may be issued for no consideration.

**Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE**

Incorporated herein by reference is the information appearing under the caption “Related Party Transactions” in the Company’s definitive Proxy Statement for the Registrant’s 2013 Annual Meeting of Shareholders to be filed with the Securities and Exchange Commission within 120 days after February 2, 2013.

**Item 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

Incorporated herein by reference is the information appearing under the caption “Other Matters” in the Company’s definitive Proxy Statement for the Registrant’s 2013 Annual Meeting of Shareholders to be filed with the Securities and Exchange Commission within 120 days after February 2, 2013.

**PART IV****Item 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES**15(a) (1) Financial Statements

The Consolidated Financial Statements and Notes are listed in the Index to Consolidated Financial Statements on page F-1 of this report.

15(a) (2) Financial Statement Schedules

Consolidated Financial Statement Schedules not filed herein have been omitted as they are not applicable or the required information or equivalent information has been included in the Consolidated Financial Statements or the notes thereto.

15(a) (3) Exhibits

Exhibits are as set forth in the “Index to Exhibits” which follows the Notes to the Consolidated Financial Statements and immediately precedes the exhibits filed.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

### TRANS WORLD ENTERTAINMENT CORPORATION

Date: April 18, 2013

By:   /s/ Robert J. Higgins  

**Robert J. Higgins**  
**Chairman and Chief Executive Officer**

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>  /s/ ROBERT J. HIGGINS  </u> <b>(Robert J. Higgins)</b>	Chairman and Chief Executive Officer (Principal Executive Officer)	April 18, 2013
<u>  /s/ JOHN ANDERSON  </u> <b>(John Anderson)</b>	Chief Financial Officer (Principal Financial and Chief Accounting Officer)	April 18, 2013
<u>  /s/ ISAAC KAUFMAN  </u> <b>(Isaac Kaufman)</b>	Director	April 18, 2013
<u>  /s/ DR. JOSEPH G. MORONE  </u> <b>(Dr. Joseph G. Morone)</b>	Director	April 18, 2013
<u>  /s/ ROBERT MARKS  </u> <b>(Robert Marks)</b>	Director	April 18, 2013
<u>  /s/ MICHAEL NAHL  </u> <b>(Michael Nahl)</b>	Director	April 18, 2013
<u>  /s/ MICHAEL B. SOLOW  </u> <b>(Michael B. Solow)</b>	Director	April 18, 2013



**TRANS WORLD ENTERTAINMENT CORPORATION**  
**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

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## Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders  
Trans World Entertainment Corporation:

We have audited the accompanying consolidated balance sheets of Trans World Entertainment Corporation and subsidiaries (the “Company”) as of February 2, 2013 and January 28, 2012, and the related consolidated statements of operations, comprehensive income (loss), shareholders’ equity, and cash flows for each of the fiscal years in the three-year period ended February 2, 2013. These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Trans World Entertainment Corporation and subsidiaries as of February 2, 2013 and January 28, 2012, and the results of their operations and their cash flows for each of the fiscal years in the three-year period ended February 2, 2013, in conformity with U.S. generally accepted accounting principles.

/s/ KPMG LLP  
Albany, New York  
April 18, 2013

**TRANS WORLD ENTERTAINMENT CORPORATION AND SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEETS**

(\$ in thousands, except per share and share amounts)

	<u>February 2, 2013</u>	<u>January 28, 2012</u>
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents .....	\$ 132,982	\$ 88,515
Accounts receivable.....	4,015	6,673
Merchandise inventory.....	155,429	191,327
Prepaid expenses and other.....	5,350	1,940
Total current assets.....	<u>297,776</u>	<u>288,455</u>
FIXED ASSETS, net.....	9,057	16,651
OTHER ASSETS.....	8,407	8,014
<b>TOTAL ASSETS.....</b>	<u><b>\$ 315,240</b></u>	<u><b>\$ 313,120</b></u>
<b>LIABILITIES</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable.....	\$ 79,438	\$ 93,141
Accrued expenses and other current liabilities.....	14,789	17,112
Accrued incentives.....	7,667	6,124
Deferred revenue.....	5,797	6,280
Current portion of long-term debt.....	—	680
Current portion of capital lease obligations.....	936	823
Total current liabilities.....	<u>108,627</u>	<u>124,160</u>
LONG—TERM DEBT, less current portion.....	—	1,068
CAPITAL LEASE OBLIGATIONS, less current portion.....	2,004	2,941
OTHER LONG-TERM LIABILITIES.....	23,849	23,105
<b>TOTAL LIABILITIES.....</b>	<u><b>134,480</b></u>	<u><b>151,274</b></u>
<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; 56,728,146 shares and 56,557,519 shares issued, respectively).....	567	566
Additional paid-in capital.....	309,451	308,791
Treasury stock at cost (25,102,990 shares).....	(217,555)	(217,555)
Accumulated other comprehensive loss.....	(2,774)	(2,157)
Retained earnings.....	91,071	72,201
<b>TOTAL SHAREHOLDERS' EQUITY.....</b>	<u><b>180,760</b></u>	<u><b>161,846</b></u>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY ...</b>	<u><b>\$ 315,240</b></u>	<u><b>\$ 313,120</b></u>

See Accompanying Notes to Consolidated Financial Statements.

**TRANS WORLD ENTERTAINMENT CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
(in thousands, except per share amounts)

	Fiscal Year Ended		
	February 2, 2013	January 28, 2012	January 29, 2011
Net sales .....	\$458,544	\$542,589	\$ 652,416
Cost of sales.....	<u>286,422</u>	<u>344,435</u>	<u>433,036</u>
Gross profit.....	172,122	198,154	219,380
Selling, general and administrative expenses.....	158,572	192,653	244,749
Gain on sale of asset .....	(22,750)	—	—
Asset impairment charges.....	<u>—</u>	<u>—</u>	<u>1,973</u>
Income (loss) from operations.....	36,300	5,501	(27,342)
Interest expense .....	2,384	3,429	3,557
Other income .....	<u>(66)</u>	<u>(240)</u>	<u>(211)</u>
Income (loss) before income taxes .....	33,982	2,312	(30,688)
Income tax expense .....	<u>248</u>	<u>150</u>	<u>275</u>
NET INCOME (LOSS).....	\$ 33,734	\$ 2,162	(\$30,963)
BASIC AND DILUTED INCOME (LOSS) PER SHARE:			
Basic income (loss) per share .....	\$ 1.07	\$ 0.07	(\$0.99)
Weighted average number of common shares outstanding— basic.....	31,577	31,520	31,417
Diluted income (loss) per share.....	\$ 1.06	\$ 0.07	(\$0.99)
Weighted average number of common shares outstanding— diluted.....	31,878	32,036	31,417
Cash dividend paid per share .....	\$ 0.47	—	—

See Accompanying Notes to Consolidated Financial Statements.

**TRANS WORLD ENTERTAINMENT CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**  
(amounts in thousands)

	Fiscal Year Ended		
	February 2, 2013	January 28, 2012	January 29, 2011
Net income (loss).....	\$33,734	\$ 2,162	(\$30,963)
Pension loss adjustment .....	(617)	(2,573)	(1,102)
Comprehensive income (loss).....	\$33,117	(\$411)	(\$32,065)

See Accompanying Notes to Consolidated Financial Statements.

**TRANS WORLD ENTERTAINMENT CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**  
(amounts in thousands)

	Common Shares	Common Stock	Additional Paid-in Capital	Treasury Shares	Treasury Stock At Cost	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Shareholders' Equity
Balance as of January 30, 2010.....	56,498	\$565	\$307,823	(25,103)	(\$217,555)	\$ 1,518	\$101,002	\$193,353
Net loss .....	—	—	—	—	—	—	(30,963)	(30,963)
Pension loss adjustment .....	—	—	—	—	—	(1,102)	—	(1,102)
Stock compensation .....	—	—	350	—	—	—	—	350
Issuance of stock to Directors.....	29	—	160	—	—	—	—	160
Balance as of January 29, 2011.....	56,527	\$565	\$308,333	(25,103)	(\$217,555)	\$ 416	\$ 70,039	\$161,798
Net income.....	—	—	—	—	—	—	2,162	2,162
Pension loss adjustment .....	—	—	—	—	—	(2,573)	—	(2,573)
Stock compensation .....	—	—	298	—	—	—	—	298
Issuance of stock to Directors.....	30	1	160	—	—	—	—	161
Balance as of January 28, 2012.....	56,557	\$566	\$308,791	(25,103)	(\$217,555)	(\$2,157)	\$ 72,201	\$161,846
Net income.....	—	—	—	—	—	—	33,734	33,734
Pension loss adjustment .....	—	—	—	—	—	(617)	—	(617)
Stock compensation .....	—	—	97	—	—	—	—	97
Exercise of equity grants.....	171	1	563	—	—	—	—	564
Cash dividends paid.....	—	—	—	—	—	—	(14,864)	(14,864)
Balance as of February 2, 2013.....	56,728	\$567	\$309,451	(25,103)	(\$217,555)	(\$2,774)	\$ 91,071	\$180,760

See Accompanying Notes to Consolidated Financial Statements.

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

	Fiscal Year Ended		
	February 2, 2013	January 28, 2012	January 29, 2011
<b>OPERATING ACTIVITIES:</b>			
Net income (loss).....	\$ 33,734	\$ 2,162	(\$30,963)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation of fixed assets.....	4,437	6,630	12,197
Asset impairment charges.....	—	—	1,973
Amortization of lease valuations, net.....	138	264	(39)
Long term incentive compensation.....	97	312	631
Loss on disposal of fixed assets.....	151	302	1,204
Gain on sale of asset.....	(22,750)	—	—
Gain on bargain purchase.....	—	—	(95)
Increase in cash surrender value.....	(668)	(143)	(832)
Changes in operating assets and liabilities, net of effects of acquisition:			
Accounts receivable.....	2,658	(1,425)	(743)
Merchandise inventory.....	35,898	42,837	34,891
Prepaid expenses and other.....	(3,632)	1,197	7,420
Other assets.....	137	1,264	(1,444)
Accounts payable.....	(13,703)	(36,866)	(542)
Accrued expenses, accrued incentives, deferred revenue and other current liabilities.....	(1,608)	(936)	(12,230)
Other long-term liabilities.....	744	1,173	(964)
Net cash provided by operating activities.....	<u>35,633</u>	<u>16,771</u>	<u>10,464</u>
<b>INVESTING ACTIVITIES:</b>			
Purchases of fixed assets.....	(3,351)	(2,105)	(2,944)
Proceeds from sale of asset.....	29,057	—	—
Acquisition of business, net of cash received.....	—	—	(1,848)
Net cash provided by (used in) investing activities...	<u>25,706</u>	<u>(2,105)</u>	<u>(4,792)</u>
<b>FINANCING ACTIVITIES:</b>			
Cash dividends paid.....	(14,864)	—	—
Exercise of long term equity awards.....	564	—	—
Payments of long-term debt.....	(1,748)	(640)	(602)
Payments of capital lease obligations.....	(824)	(723)	(1,372)
Net cash used in financing activities.....	<u>(16,872)</u>	<u>(1,363)</u>	<u>(1,974)</u>
Net increase in cash and cash equivalents.....	44,467	13,303	3,698
Cash and cash equivalents, beginning of year.....	88,515	75,212	71,514
Cash and cash equivalents, end of year.....	<u>\$132,982</u>	<u>\$ 88,515</u>	<u>\$ 75,212</u>
<b>Supplemental disclosures and non-cash investing and financing activities:</b>			
Interest paid.....	\$ 2,408	\$ 3,206	\$ 3,595

See Accompanying Notes to Consolidated Financial Statements.

**TRANS WORLD ENTERTAINMENT CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1. Nature of Operations and Summary of Significant Accounting Policies**

**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 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 February 2, 2013, the Company operated 358 stores totaling approximately 2.2 million square feet in the United States, the District of Columbia, the Commonwealth of Puerto Rico and the U.S. Virgin Islands. The Company’s business is seasonal in nature, with the peak selling period being the holiday season which falls in the Company’s fourth fiscal quarter.

**Liquidity:** The Company’s primary sources of working capital are cash provided by operations and borrowing capacity under its revolving credit facility. 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, the related terms on the purchases and capital expenditures. Management believes it will have adequate resources to fund its cash needs for the foreseeable future, including its capital spending, its seasonal increase in merchandise inventory and other operating cash requirements and commitments. Management continued many of the initiatives begun in 2011, as part of the execution of its operating plan for 2012; including a focus on the operation of a core base of stores, improved product selection based on customer preferences and industry changes, as well as further streamlining of its operations. During Fiscal 2012, management carried out certain strategic initiatives in its efforts to reduce certain operating costs. In addition, management closed 33 stores and plans to continue its evaluation of profitability of the Company’s store in consideration of lease terms, conditions and expirations, including considering new and relocated stores.

Management anticipates any cash requirements due to a shortfall in cash from operations will be funded by the Company’s amended revolving credit facility, discussed hereafter.

**Basis of Presentation:** The 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 preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions, including those related to merchandise inventory and return costs, valuation of long-lived assets, income taxes, and accounting for gift card liability, 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.

**Items Affecting Comparability:** The Company’s fiscal year is a 52 or 53-week period ending the Saturday nearest to January 31. Fiscal 2012, 2011, and 2010 ended February 2, 2013, January 28, 2012, and January 29, 2011, respectively. Fiscal 2012 had 53 weeks and 2011 and 2010 had 52 weeks. The 53rd week in Fiscal 2012 contributed less than 2% to net sales.

**Concentration of Business Risks:** The Company purchases inventory from approximately 500 suppliers. In Fiscal 2012, 63% of purchases were made from ten suppliers including EMI Music Distribution, Sony Music Entertainment, Warner Music Group, Universal Music Group Distribution, Fox Video Inc., Paramount Home Entertainment Inc., Walt Disney Studios Home Entertainment, Warner Home Entertainment, Universal Studios Home Entertainment and Sony Pictures Home Entertainment. The Company does not have material long-term purchase contracts; rather, it purchases products from its suppliers on an order-by-order basis. Historically, the Company has not experienced difficulty in obtaining satisfactory sources of supply and management believes that it will continue to have access to adequate sources of supply.



# TRANS WORLD ENTERTAINMENT CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

**Cash and Cash Equivalents:** The Company considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

**Concentration of Credit Risks:** The Company maintains centralized cash management and investment programs whereby excess cash balances are invested in short-term money market funds. The Company's investments consist of short-term investment grade securities consistent with its investment guidelines. These guidelines include the provision that sufficient liquidity will be maintained to meet anticipated cash flow needs. The Company maintains these investments, all of which are classified as cash equivalents due to their short term nature, with various financial institutions. These amounts often exceed the FDIC insurance limits. The Company limits the amount of credit exposure with any one financial institution and believes that no significant concentration of credit risk exists with respect to cash investments.

**Accounts Receivable:** Accounts receivable are comprised of receivables and other individually insignificant amounts. There are no provisions for uncollectible amounts from retail sales of merchandise inventory since payment is received at the time of sale.

**Merchandise Inventory and Return Costs:** Merchandise inventory is stated at the lower of cost or market under the average cost method. Inventory valuation requires significant judgment and estimates, including obsolescence, shrink and any adjustments to market value, if market value is lower than cost. The Company records obsolescence and any adjustments to market value (if lower than cost) based on current and anticipated demand, customer preferences and market conditions. The provision for inventory shrink is estimated as a percentage of store sales for the period from the last date a physical inventory was performed to the end of the fiscal year. Such estimates are based on historical results and trends, and the shrink results from the last physical inventory. Physical inventories are taken at least annually for all stores and distribution centers throughout the year, and inventory records are adjusted accordingly.

The Company is generally entitled to return merchandise purchased from major music vendors for credit against other purchases from these vendors. Certain vendors reduce the credit with a merchandise return charge which varies depending on the type of merchandise being returned. Certain other vendors charge a handling fee based on units returned. The Company records merchandise return charges in cost of sales.

**Fixed Assets and Depreciation:** Fixed assets are recorded at cost and depreciated or amortized over the estimated useful life of the asset using the straight-line method. The estimated useful lives are as follows:

Leasehold improvements	Lesser of estimated useful life of the asset or the lease term
Fixtures and equipment	3-7 years
Buildings and improvements	10-30 years

Major improvements and betterments to existing facilities and equipment are capitalized. Expenditures for maintenance and repairs are expensed as incurred. Amortization of capital lease assets is included in depreciation and amortization expense.

**Impairment of Long-Lived Assets:** Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to undiscounted future net cash flows expected to be generated by the asset over its remaining useful life. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Fair value is generally measured based on discounted estimated future cash flows. Assets to be disposed of would be separately presented in the Consolidated Balance Sheets and reported at the lower of the carrying amount or fair value less

# TRANS WORLD ENTERTAINMENT CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

disposition costs. For the purpose of the asset impairment test, the Company has two asset groupings—corporate and store level assets.

The Company did not recognize an impairment expense during Fiscal 2012 and Fiscal 2011. During Fiscal 2010, the Company recorded an asset impairment charge of \$2.0 million related to the write down of certain long-lived assets at underperforming store locations. Losses for store closings in the ordinary course of business represent the write down of the net book value of abandoned fixtures and leasehold improvements. The loss on disposal of fixed assets related to store closings was \$0.2 million, \$0.3 million and \$1.2 million in Fiscal 2012, 2011 and 2010, respectively, and is included in selling, general and administrative (“SG&A”) expenses in the Consolidated Statements of Operations and loss on disposal of fixed assets in the Consolidated Statements of Cash Flows. Store closings usually occur at the expiration of the lease, at which time leasehold improvements, which constitute a majority of the abandoned assets, are fully depreciated.

**Conditional Asset Retirement Obligations:** The Company records the fair value of an asset retirement obligation (“ARO”) as a liability in the period in which it incurs a legal obligation associated with the retirement of tangible long-lived assets that result from the acquisition, construction, development, and/or normal use of the asset. The Company also records a corresponding asset that is depreciated over the life of the asset. Subsequent to its initial measurement, the ARO is adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation.

**Commitments and Contingencies:** 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 or in the aggregate, will not have a material adverse effect on the results of operations and financial condition of the Company.

**Revenue Recognition:** The Company’s revenue is primarily from retail sales of merchandise inventory. Revenue is recognized at the point-of-sale. Internet sales are recognized as revenue upon shipment. Shipping and handling fee income from the Company’s Internet operations is recognized as net sales. Loyalty card revenue is amortized over the life of the membership period. Net sales are recorded net of estimated amounts for sales returns and other allowances. The Company records shipping and handling costs in cost of sales. Net sales are recorded net of applicable sales taxes.

**Cost of Sales:** In addition to the cost of product, the Company includes in cost of sales those costs associated with purchasing, receiving, shipping, inspecting and warehousing product. Also included are costs associated with the return of product to vendors. Cost of sales further includes the cost of inventory shrink losses and obsolescence and the benefit of vendor allowances and discounts.

**Selling, General and Administrative (“SG&A”) Expenses:** Included in SG&A expenses are payroll and related costs, store operating costs, occupancy charges, professional and service fees, general operating and overhead expenses and depreciation charges (excluding those related to distribution operations, as discussed in Note 2 of Notes to the Consolidated Financial Statements in this Annual Report on Form 10-K). Selling, general and administrative expenses also include fixed asset write offs associated with store closures, if any, and miscellaneous items, other than interest.

**Advertising Costs and Vendor Allowances:** The Company often receives allowances from its vendors to fund in-store displays, print, radio and television advertising, and other promotional events. Vendor advertising allowances which exceed specific, incremental and identifiable costs incurred in relation to the advertising and promotions offered by the Company to its vendors are classified as a reduction in the purchase price of merchandise inventory. Accordingly, advertising and sales promotion costs are charged to operations, offset by direct vendor reimbursements, as incurred. Total advertising expense, excluding vendor allowances, was \$4.1 million, \$4.8 million, and \$8.9 million in Fiscal 2012, 2011, and 2010, respectively. In the aggregate, vendor allowances supporting

# TRANS WORLD ENTERTAINMENT CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

the Company's advertising and promotion included as a reduction of SG&A expenses, as reimbursements of such costs were \$4.0 million, \$4.8 million, and \$8.8 million in Fiscal 2012, 2011, and 2010, respectively.

**Lease Accounting:** The Company's calculation of straight-line rent expense includes the impact of escalating rents for periods in which it is reasonably assured of exercising lease options and includes in the lease term any period during which the Company is not obligated to pay rent while the store is being constructed ("rent holiday"). The Company accounts for step rent provisions, escalation clauses and other lease concessions by recognizing these amounts on a straight line basis over the initial lease term. The Company capitalizes leasehold improvements funded by tenant improvement allowances, depreciating them over the term of the related leases. The tenant improvement allowances are recorded as deferred rent within other long-term liabilities in the Consolidated Balance Sheet and are amortized as a reduction in rent expense over the life of the related leases.

**Store Closing Costs:** Management periodically considers the closing of underperforming stores. In the event of a store closing, reserves are established at the time a liability is incurred for the present value of any remaining lease obligations, net of estimated sublease income, and other exit costs. Store closings are not considered discontinued operations due to the expected migration of sales to ongoing stores.

**Gift Cards:** The Company offers gift cards for sale. A deferred income account, which is included in accrued expenses and other current liabilities in the Consolidated Balance Sheets, is established for gift cards issued. The deferred income balance related to gift cards was \$4.5 million and \$5.5 million at the end of Fiscal 2012 and 2011, respectively. When gift cards are redeemed at the store level, revenue is recorded and the related liability is reduced. Breakage is estimated based on the historical relationship of the redemption of gift cards redeemed to gift cards sold, over a certain period of time. The Company has the ability to reasonably and reliably estimate gift card liability based on historical experience with redemption rates associated with a large volume of homogeneous transactions, from a period of more than ten years. The Company's estimate is not susceptible to significant external factors and the circumstances around purchases and redemptions have not changed significantly over time. The Company recorded breakage on its gift cards for Fiscal 2012, 2011 and 2010 in the amount of \$1.0 million, \$1.7 million and \$2.1 million, respectively. Gift card breakage is recorded as a reduction of SG&A expenses.

**Income Taxes:** Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Deferred tax assets are subject to valuation allowances based upon management's estimates of realizability.

The Company recognizes the effect of income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs. It is the Company's practice to recognize interest and penalties related to income tax matters in income tax expense (benefit) in the consolidated statements of operations.

**Stock-Based Compensation:** Stock-based compensation represents the cost related to stock-based awards granted to employees and directors. The Company measures stock-based compensation cost at grant date, based on the estimated fair value of the award, and recognizes the cost as expense on a straight-line basis (net of estimated forfeitures) over the option's requisite service period. The

# TRANS WORLD ENTERTAINMENT CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Company recognizes compensation expense based on estimated grant date fair value using the Black-Scholes option-pricing model. Tax benefits, if any, resulting from tax deductions in excess of the compensation cost recognized for those options are to be classified and reported as both an operating cash outflow and financing cash inflow.

**Comprehensive Income (Loss):** Comprehensive income (loss) consists of net income and pension loss adjustment.

**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 (loss) per share is calculated 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.

The following is a reconciliation of the basic weighted average number of shares outstanding to the diluted weighted average number of shares outstanding:

	Fiscal Year		
	2012	2011	2010
	(in thousands)		
Weighted average common shares outstanding—basic .....	31,577	31,520	31,417
Dilutive effect of outstanding stock awards .....	301	516	—
Weighted average common shares outstanding—diluted .....	<u>31,878</u>	<u>32,036</u>	<u>31,417</u>
Antidilutive stock awards .....	<u>4,541</u>	<u>5,007</u>	<u>4,817</u>

As the Company recorded a net loss during Fiscal 2010, the impact of all outstanding stock awards was not considered as such impact would be antidilutive.

**Fair Value of Financial Instruments:** The carrying amounts reported in the Consolidated Balance Sheets for cash and cash equivalents, accounts receivable, accounts payable and other current liabilities approximate fair value because of the immediate or short-term maturity of these financial instruments. The carrying value of life insurance policies included in other assets approximates fair value based on estimates received from insurance companies. For all applicable periods, the carrying value of the Company's long-term debt including current portion, approximates fair value based on estimated discounted future cash flows for remaining maturities and rates currently offered to the Company for similar debt instruments.

**Segment Information:** The Company has one reportable segment.

### Note 2. Fixed Assets

Fixed assets consist of the following:

	February 2, 2013	January 28, 2012
	(\$ in thousands)	
Buildings and improvements .....	\$ 9,938	\$ 17,288
Fixtures and equipment .....	117,874	118,334
Leasehold improvements .....	<u>31,346</u>	<u>30,943</u>
Fixed assets .....	159,158	166,565
Allowances for depreciation and amortization .....	<u>(150,101)</u>	<u>(149,914)</u>
Fixed assets, net .....	<u>\$ 9,057</u>	<u>\$ 16,651</u>

**TRANS WORLD ENTERTAINMENT CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

Depreciation of fixed assets is included in the Consolidated Statements of Operations as follows:

	Fiscal Year		
	2012	2011	2010
	(\$ in thousands)		
Cost of sales.....	\$ 496	\$ 536	\$ 1,143
Selling, general and administrative expenses.....	3,941	6,094	11,054
Total .....	\$4,437	\$6,630	\$12,197

Depreciation expense related to the Company’s distribution center facility and related equipment is included in cost of sales. All other depreciation and amortization of fixed assets is included in SG&A expenses.

**Note 3. Gain on Sale of Asset**

During Fiscal 2012, the Company sold real property in Miami, Florida. The Company received proceeds of \$29.1 million from the sale. The Company recorded a gain on the sale of \$22.8 million, net of the carrying cost of the asset and fees related to the sale.

**Note 4. Impairment of Long-Lived Assets**

During Fiscal 2010, the Company concluded, based on a significant decline in sales and earnings during the fourth quarter of that year, that triggering events had occurred requiring a test of long-lived assets for impairment at its retail stores and consolidated subsidiaries. Long-lived assets at locations where impairment was determined to exist were written down to their estimated fair values as of the end of the period, resulting in the recording of an asset impairment charge of \$2.0 million. Estimated fair values for long-lived assets at these locations, including store fixtures and equipment and leasehold improvements, were determined based on a measure of discounted future cash flows over the remaining lease terms at the respective locations. Future cash flows were estimated based on store operating plans and were discounted at a rate approximating the Company’s cost of capital without reference to market transactions. Management believes its assumptions were reasonable and consistently applied. The Company did not recognize an impairment charge during Fiscal 2012 and Fiscal 2011.

**Note 5. Debt**

**Credit Facility**

On January 5, 2006, the Company entered into a five year, \$100 million revolving secured credit facility agreement (“Credit Facility”) with Bank of America, N.A. At the election of the Company, loans under the Credit Facility bear interest on the principal amount at a rate equal to either the Prime Rate or LIBOR plus 0.75%. Payments of amounts due under the Credit Facility are secured by the assets of the Company.

On March 23, 2006, the Company entered into a First Amendment of the Credit Facility with Bank of America, N.A. which increased the maximum amount available for borrowing under the revolving secured credit facility to \$130 million, under the same terms and conditions.

On October 20, 2006, the Company entered into a Second Amendment of the Credit Facility with Bank of America, N.A. which increased the maximum amount available for borrowing under the revolving secured credit facility to \$150 million, under the same terms and conditions. The availability under the Credit Facility is subject to limitations based on sufficient inventory levels.

# TRANS WORLD ENTERTAINMENT CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

### Amended Credit Facility

In April 2010, the Company entered into an amended and restated Credit Agreement (“Amended Credit Facility”) with Bank of America, N.A. which reduced the availability under the facility to \$100 million. The Amended Credit Facility updates certain terms and conditions including prohibiting the payment of dividends, added covenants around the number of store closings and changed the formula for interest rates. The availability under the Amended Credit Facility is subject to limitations based on sufficient inventory levels. The principal amount of all outstanding loans under the Amended Credit Facility together with any accrued but unpaid interest are due and payable in April 2013, unless otherwise paid earlier pursuant to the terms of the Amended Credit Facility. Payments of amounts due under the Amended Credit Facility are secured by the assets of the Company.

### Second Amended Credit Facility

In May 2012, the Company entered into a \$75 million credit facility (“Second Amended Credit Facility”) which amended the Amended Credit Facility. As part of the amendment, the Administrative Agent, Collateral Agent, Swingline Lender and Issuing Bank was transferred from Bank of America to Wells Fargo. The principal amount of all outstanding loans under the Second Amended 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 Second Amended Credit Facility. Payments of amounts due under the Second Amended Credit Facility are secured by the assets of the Company.

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

Interest under the Second Amended 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 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 Second Amended Credit Facility is subject to limitations based on sufficient inventory levels.

As of February 2, 2013 and January 28, 2012, the Company did not have any borrowings under the Second Amended Credit Facility or the Amended Credit Facility. During Fiscal 2012 and Fiscal 2011, the Company did not have any borrowings under the Second Amended Credit Facility or the Amended Credit Facility. During Fiscal 2010, the highest aggregate balance outstanding under the revolving credit facility was \$32.9 million. As of February 2, 2013 and January 28, 2012, the Company had \$0.3 million of outstanding letter of credit obligations under the Second Amended and the Amended Credit Facility. The Company had \$54 million and \$69 million available for borrowing as of February 2, 2013 and January 28, 2012, respectively.

### Mortgage Loan

During Fiscal 2004, the Company borrowed \$5.8 million under a mortgage loan to finance the purchase of real estate. During Fiscal 2012, the Company prepaid the remaining obligation on the mortgage loan. No future obligation exists.

**TRANS WORLD ENTERTAINMENT CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**Note 6. Income Taxes**

Income tax expense consists of the following:

	Fiscal Year		
	2012	2011	2010
	(\$ in thousands)		
Federal—current .....	\$ 18	(\$15)	\$ 30
State—current .....	230	165	245
Deferred .....	—	—	—
Income tax expense .....	\$248	\$ 150	\$275

A reconciliation of the Company's effective income tax rate with the federal statutory rate is as follows:

	Fiscal Year		
	2012	2011	2010
Federal statutory rate .....	35.0%	35.0%	35.0%
State income taxes, net of federal tax effect .....	0.5%	4.6%	(0.5%)
Change in valuation allowance .....	(34.3%)	(32.8%)	(35.7%)
Cash surrender value—insurance/benefit programs .....	(0.6%)	(1.1%)	0.8%
Other .....	0.1%	0.8%	(0.5%)
Effective income tax rate .....	0.7%	6.5%	(0.9%)

The Other category is comprised of various items, including the impacts of non deductible meals, dues, penalties, amortization and graduated tax brackets.

Significant components of the Company's deferred tax assets are as follows:

	February 2, 2013	January 28, 2012
	(\$ in thousands)	
<b>DEFERRED TAX ASSETS</b>		
Accrued expenses .....	\$ 999	\$ 1,120
Inventory .....	278	601
Retirement and compensation related accruals .....	10,290	9,058
Fixed assets .....	10,374	13,996
Federal and state net operating loss and credit carryforwards .....	74,642	83,849
Real estate leases, including deferred rent .....	2,299	3,117
Losses on investments .....	1,221	1,623
Goodwill .....	1,160	2,018
Other .....	926	913
Gross deferred tax assets before valuation allowance .....	102,189	116,295
Less: valuation allowance .....	(102,189)	(116,295)
Total deferred tax assets .....	\$ —	\$ —
<b>DEFERRED TAX LIABILITIES</b> .....		
	—	—
<b>NET DEFERRED TAX ASSET</b> .....	\$ —	\$ —

The Company has a net operating loss carryforward of \$153.4 million for federal income tax purposes and approximately \$266 million for state income tax purposes as of the end of Fiscal 2012 that expire at various times through 2031 and are subject to certain limitations and statutory expiration periods. The state net operating loss carryforwards are subject to various business apportionment factors and multiple jurisdictional requirements when utilized. The Company has federal tax credit carryforwards of \$1.2 million, of which \$0.2 million will expire in 2026, with the remainder available indefinitely. The Company has state tax credit carryforwards of \$1.1 million, of which \$0.3 million will expire in 2027.

**TRANS WORLD ENTERTAINMENT CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

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 upon 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 the available objective evidence, management concluded that a full valuation allowance should be recorded against its deferred tax assets. As of February 2, 2013, the valuation allowance decreased to \$102.2 million from \$116.3 million at January 28, 2012. The reduction in the Company's deferred tax assets was caused primarily by the utilization of federal and state net operating loss carryforwards to absorb the taxable gain realized on the gain on sale of asset (see Note 3. in the Notes to the Consolidated Financial Statements). The valuation allowance equal to the gross deferred tax assets is consistent with the Company's decision to record a full valuation allowance against deferred tax assets that have been recorded in the normal course of business, as described above. Management will continue to assess the valuation allowance against the gross deferred assets.

During Fiscal 2012, Fiscal 2011 and Fiscal 2010 the Company paid income taxes, net of refunds, of approximately \$0.1 million, \$0.1 million and \$0.2 million, respectively.

A reconciliation of the beginning and ending amounts of unrecognized tax benefits for the respective years is provided below. Amounts presented excluded interest and penalties, where applicable, on unrecognized tax benefits:

	<u>Fiscal 2012</u>	<u>Fiscal 2011</u>	<u>Fiscal 2010</u>
	(\$ in thousands)		
Unrecognized tax benefits at beginning of the year.....	\$2,078	\$2,308	\$2,360
Increases in tax positions from prior years.....	—	—	29
Decreases in tax positions from prior years.....	—	—	—
Increases in tax positions for current year.....	—	—	—
Settlements.....	—	—	—
Lapse of applicable statute of limitations.....	—	(230)	(81)
Unrecognized tax benefits at end of the year.....	<u>\$2,078</u>	<u>\$2,078</u>	<u>\$2,308</u>

As of February 2, 2013, the Company had \$2.1 million of gross unrecognized tax benefits, \$1.5 million of which would affect the Company's tax rate if recognized. While it is reasonably possible that the amount of unrecognized tax benefits will increase or decrease within the next twelve months, the Company does not expect the change to have a significant impact on its results of operations or financial position.

The Company is subject to U.S. federal income tax as well as income tax of multiple state jurisdictions. The Company has substantially concluded all federal income tax matters and all material state and local income tax matters through Fiscal 2008.

The Company's practice is to recognize interest and penalties associated with its unrecognized tax benefits as a component of income tax expense in the Company's Consolidated Statement of Operations. During Fiscal 2012, the Company accrued a provision for interest and penalties of \$0.2 million. As of February 2, 2013, the liability for uncertain tax positions reflected in the Company's Consolidated Balance Sheets was \$2.4 million, including accrued interest and penalties of \$1.6 million.



**TRANS WORLD ENTERTAINMENT CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**Note 7. Leases**

**Leases—lessee**

As more fully discussed in Note 9 in the Notes to Consolidated Financial Statements, the Company leases its Albany, NY distribution center and administrative offices under three capital lease arrangements from its Chairman, Chief Executive Officer and largest shareholder.

Fixed assets recorded under capital leases, which are included in fixed assets on the accompanying Consolidated Balance Sheets, are as follows:

	February 2, 2013	January 28, 2012
	(\$ in thousands)	
Buildings .....	\$ 9,342	\$ 9,342
Allowances for depreciation and amortization .....	(7,591)	(7,259)
	\$ 1,751	\$ 2,083

At February 2, 2013, the Company leased 358 stores under operating leases, many of which contain renewal options, for periods ranging from one to ten years. Most leases also provide for payment of operating expenses and real estate taxes. Some also provide for contingent rent based on percentage of sales over a certain sales volume.

Net rental expense was as follows:

	Fiscal Year		
	2012	2011	2010
	(\$ in thousands)		
Minimum rentals .....	\$39,591	\$50,064	\$64,353
Contingent rentals .....	43	91	204
	\$39,634	\$50,155	\$64,557

Future minimum rental payments required under all leases that have initial or remaining non-cancelable lease terms at February 2, 2013 are as follows:

	Operating Leases	Capital Leases
	(\$ in thousands)	
2013 .....	31,053	2,251
2014 .....	16,249	2,251
2015 .....	9,937	1,723
2016 .....	4,131	—
2017 .....	2,623	—
Thereafter .....	1,228	—
Total minimum payments required .....	\$65,221	\$ 6,225
Less: amounts representing interest .....		(3,285)
Present value of minimum lease payments .....		2,940
Less: current portion .....		936
Long-term capital lease obligations .....		\$ 2,004

In addition to the obligations in the table above, a number of the Company's stores have leases which have rent payments based on the store's sales volume in lieu of fixed minimum rent payments. During Fiscal 2012, minimum rent payments based on a store's sales volume were \$1.4 million.

# TRANS WORLD ENTERTAINMENT CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

### Note 8. Benefit Plans

#### 401(k) Savings Plan

The Company offers a 401(k) Savings Plan to eligible employees meeting certain age and service requirements. This plan permits participants to contribute up to 80% of their salary, including bonuses, up to the maximum allowable by IRS regulations. Participants are immediately vested in their voluntary contributions plus actual earnings thereon. As of March 1, 2011, the Company suspended its matching contribution. Prior to termination of the Company's matching contribution, participant vesting of the Company's matching and profit sharing contribution was based on the years of service completed by the participant. Participants are fully vested upon the completion of four years of service. All participant forfeitures of non-vested benefits are used to reduce the Company's contributions or fees in future years. Total expense related to the Company's matching contribution was approximately \$0, \$3,000 and \$439,000 in Fiscal 2012, 2011 and 2010, respectively. Effective May 1, 2013, the Company will reinstate its matching contribution.

#### Stock Award Plans

The Company has five employee stock award plans, the 1994 Stock Option Plan, the 1998 Stock Option Plan, the 1999 Stock Option Plan and the 2002 Stock Option Plan (the "Old Plans"); and the 2005 Long Term Incentive and Share Award Plan (the "New Plan"). Additionally, the Company had a stock award plan for non-employee directors (the "1990 Plan"). The Company no longer issues stock options under the Old Plans.

Equity awards authorized for issuance under the Old Plans, New Plan and 1990 Plan total 20.6 million. As of February 2, 2013, of the awards authorized for issuance under the Old Plans, New Plan and 1990 Plan, 4.8 million were granted and are outstanding, 4.1 million of which were vested and exercisable. Shares available for future grants of options and other share based awards at February 2, 2013 and January 28, 2012 were 2.6 million and 2.2 million, respectively.

Total stock-based compensation expense recognized in the Consolidated Statements of Operations for Fiscal 2012, Fiscal 2011 and Fiscal 2010 was \$0.1 million, \$0.3 million and \$0.6 million. For Fiscal 2012, Fiscal 2011 and Fiscal 2010 the related total deferred tax benefit was \$0. As of February 2, 2013, there was \$0.5 million of unrecognized compensation cost related to stock option awards that is expected to be recognized as expense over a weighted average period of 2.4 years.

The fair values of the options granted have been estimated at the date of grant using the Black—Scholes option pricing model with the following assumptions:

	<u>Stock Option Plan</u>		
	<u>2012</u>	<u>2011</u>	<u>2010</u>
Dividend yield.....	0%	0%	0%
Expected volatility.....	68.5%-76.8%	69.9%-75.4%	76.4%-81.9%
Risk-free interest rate .....	0.69%-0.98%	1.42%-2.81%	1.99%-2.13%
Expected option life in years .....	4.92-6.98	4.92-6.98	4.03-5.45
Weighted average fair value per share of options granted during the year .....	\$1.70	\$1.27	\$1.33

**TRANS WORLD ENTERTAINMENT CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

The following table summarizes information about stock option awards outstanding under the Old Plans, New Plan and 1990 Plan as of February 2, 2013:

Exercise Price Range	Outstanding			Exercisable			
	Shares	Average Remaining Life	Weighted Average Exercise Price	Aggregate Intrinsic Value	Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value
\$0.98-\$2.66.....	777,500	6.6	\$ 2.06	\$1,104,050	256,250	\$ 2.00	\$379,250
2.67-5.33.....	2,102,964	1.8	4.04	—	1,962,964	4.12	—
5.34-8.00.....	260,550	4.2	5.56	—	260,550	5.56	—
8.01-10.67.....	815,400	1.2	10.31	—	815,400	10.31	—
10.68-13.33.....	—	—	—	—	—	—	—
13.34-16.00.....	707,495	2.2	14.32	—	707,495	14.32	—
Total .....	<u>4,663,909</u>	2.7	\$ 6.45	<u>\$1,104,050</u>	<u>4,002,659</u>	\$ 7.14	<u>\$379,250</u>

The aggregate intrinsic value in the preceding table represents the total pretax intrinsic value based on the Company's closing stock price of \$3.48 as of February 1, 2013, which would have been received by the award holders had all award holders under the Old Plans, New Plan and 1990 Plan exercised their awards as of that date.

The following table summarizes stock option activity under the Stock Award Plans:

	Employee and Director Stock Award Plans				
	Number of Shares Subject To Option	Stock Award Exercise Price Range Per Share	Weighted Average Exercise Price	Other Share Awards <sup>(1)</sup>	Weighted Average Grant Date Value
Balance January 30, 2010 .....	7,109,675	\$0.98-\$14.32	\$7.91	660,065	\$2.34
Granted.....	1,000,000	1.67-2.11	2.07	279,898	2.22
Exercised .....	—	—	—	(109,364)	3.03
Forfeited.....	(107,000)	5.32-6.43	5.51	(357,879)	2.18
Canceled.....	<u>(1,315,617)</u>	<u>3.50-14.32</u>	<u>9.32</u>	<u>(279,898)</u>	<u>1.53</u>
Balance January 29, 2011 .....	6,687,058	\$0.98-\$14.32	\$6.80	192,822	\$4.19
Granted.....	310,000	1.73-2.31	2.02	279,898	1.63
Exercised .....	—	—	—	(110,276)	2.57
Forfeited.....	(12,925)	1.16-5.50	2.99	—	0.00
Canceled.....	<u>(857,282)</u>	<u>3.50-14.32</u>	<u>8.82</u>	<u>—</u>	<u>0.00</u>
Balance January 28, 2012 .....	6,126,851	\$0.98-\$14.32	\$6.28	362,444	\$2.71
Granted.....	305,000	2.53-3.05	2.76	10,491	3.53
Exercised .....	(174,250)	0.98-3.50	3.31	(279,898)	1.63
Forfeited.....	(703,750)	0.98-2.31	2.15	—	0.00
Canceled.....	<u>(889,942)</u>	<u>3.50-14.32</u>	<u>8.03</u>	<u>—</u>	<u>0.00</u>
Balance February 2, 2013 .....	<u>4,663,909</u>	<u>\$0.98-\$14.32</u>	<u>\$6.45</u>	<u>93,037</u>	<u>\$6.04</u>

<sup>(1)</sup> Other Share Awards include deferred shares granted to Directors.

During Fiscal 2012, 2011 and 2010, the Company recognized expenses of approximately \$0, \$13,000 and \$74,000, respectively, for deferred shares issued to non-employee directors.

**Defined Benefit Plans**

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

# TRANS WORLD ENTERTAINMENT CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The annual benefit amount is based on salary and bonus at the time of retirement and number of years of service.

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.

For Fiscal 2012, Fiscal 2011 and Fiscal 2010, net periodic benefit cost recognized under both plans totaled approximately \$1.1 million, \$0.7 million, and \$0.4 million, respectively. The accrued pension liability for both plans was approximately \$18.0 million and \$16.0 million at February 2, 2013 and January 28, 2012, respectively, and is recorded within other long term liabilities. The accumulated benefit obligation for both plans was approximately \$17.4 million and \$15.7 million as of February 2, 2013 and January 28, 2012, respectively.

The following is a summary of the Company’s defined benefit pension plans as of the most recent actuarial calculations:

### Obligation and Funded Status:

	February 2, 2013	January 28, 2012
	(\$ in thousands)	
Change in Projected Benefit Obligation:		
Benefit obligation at beginning of year.....	\$ 16,021	\$ 12,855
Service cost .....	90	147
Interest cost .....	638	671
Actuarial (gain)/loss .....	199	2,468
Benefits paid .....	(121)	(120)
Plan change .....	758	—
Projected Benefit obligation at end of year	<u>\$ 17,585</u>	<u>\$ 16,021</u>
Fair value of plan assets at end of year .....	<u>\$ —</u>	<u>\$ —</u>
Funded status .....	(\$17,585)	(\$16,021)
Unrecognized prior service cost .....	2,021	1,605
Unrecognized net actuarial gain .....	<u>(346)</u>	<u>(547)</u>
Accrued benefit cost .....	<u>(\$15,910)</u>	<u>(\$14,963)</u>

### Amounts recognized in the Consolidated Balance Sheets consist of:

	February 2, 2013	January 28, 2012
	(\$ in thousands)	
Current liability .....	(\$151)	(\$151)
Long term liability .....	(17,434)	(15,870)
Add: Accumulated other comprehensive loss.....	<u>1,675</u>	<u>1,058</u>
Net amount recognized	<u>(\$15,910)</u>	<u>(\$14,963)</u>

**TRANS WORLD ENTERTAINMENT CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**Components of Net Periodic Benefit Cost and Other Amounts Recognized in Other Comprehensive (Income) Loss:**

	Fiscal Year		
	2012	2011	2010
Net Periodic Benefit Cost:			
	(\$ in thousands)		
Service cost .....	\$ 90	\$ 147	\$ 133
Interest cost .....	637	671	653
Amortization of prior service cost .....	342	342	342
Amortization of net gain .....	(1)	(448)	(683)
Net periodic benefit cost	<u>\$1,068</u>	<u>\$ 712</u>	<u>\$ 445</u>

**Other Changes in Benefit Obligations Recognized in Other Comprehensive (Income) Loss:**

Net prior service cost recognized as a component of net periodic benefit cost .....	(\$342)	(\$342)
Net actuarial gain recognized as a component of net periodic benefit cost .....	1	448
Prior service cost arising during the period .....	758	—
Net actuarial loss arising during the period .....	<u>200</u>	<u>2,467</u>
	617	2,573
Income tax effect .....	—	—
Total recognized in other comprehensive loss .....	<u>\$ 617</u>	<u>\$ 2,573</u>
Total recognized in net periodic benefit cost and other comprehensive loss .....	<u>\$ 1,685</u>	<u>\$ 3,285</u>

The pre-tax components of accumulated other comprehensive income, which have not yet been recognized as components of net periodic benefit cost as of February 2, 2013, January 28, 2012 and January 29, 2011 and the tax effect are summarized below.

	February 2, 2013	January 28, 2012	January 29, 2011
	(\$ in thousands)		
Net unrecognized actuarial gain .....	(\$346)	(\$547)	(\$3,462)
Net unrecognized prior service cost .....	<u>2,021</u>	<u>1,605</u>	<u>1,947</u>
Accumulated other comprehensive loss .....	<u>1,675</u>	<u>1,058</u>	<u>(1,515)</u>
Tax expense .....	<u>1,099</u>	<u>1,099</u>	<u>1,099</u>
Accumulated other comprehensive (income) loss .....	<u>\$ 2,774</u>	<u>\$ 2,157</u>	<u>(\$416)</u>

In Fiscal 2013, approximately \$721,000 of net unrecognized prior service cost and approximately \$2,300 of the net unrecognized actuarial gain, recorded as components of accumulated other comprehensive loss at February 2, 2013, will be recognized as components of net periodic benefit cost.

**Assumptions:**

	Fiscal Year	
	2012	2011
Weighted-average assumptions used to determine benefit obligation:		
Discount rate .....	3.75%	4.00%
Salary increase rate .....	4.00%	4.00%
Measurement date .....	Feb 2, 2013	Jan 28, 2012

# TRANS WORLD ENTERTAINMENT CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

	<u>Fiscal Year</u>		
	<u>2012</u>	<u>2011</u>	<u>2010</u>
Weighted-average assumptions used to determine net periodic benefit cost:			
Discount rate .....	4.00%	4.00%	5.75%
Salary increase rate .....	4.00%	4.00%	4.00%

The discount rate is based on the rates implicit in high-quality fixed-income investments currently available as of the measurement date. The Citigroup Pension Discount Curve (CPDC) rates are intended to represent the spot rates implied by the high quality corporate bond market in the U.S. The projected benefit payments attributed to the projected benefit obligation have been discounted using the CPDC mid-year rates and the discount rate is the single constant rate that produces the same total present value.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

<u>Year</u>	<u>Pension Benefits</u> <u>(\$ in thousands)</u>
2013.....	\$ 151
2014.....	231
2015.....	1,095
2016.....	1,084
2017.....	1,095
2018 and thereafter.....	6,031

### Note 9. Shareholders' Equity

In the fourth quarter of Fiscal 2012, the Company declared and paid a special cash dividend of \$0.47 per common share. No cash dividends were paid in 2011 or 2010. The Company's amended credit facility contains certain restrictions related to the payment of cash dividends, including limiting the amount of dividends to \$5.0 million annually. On November 27, 2012, Wells Fargo Bank, National Association (the "Administrative Agent") and certain other parties to the amended credit facility agreed to consent to the use of a portion of the proceeds received from the sale of real property owned by Record Town, Inc. to pay the special cash dividend.

### Note 10. Related Party Transactions

The Company leases its 181,300 square foot distribution center/office facility in Albany, New York from Robert J. Higgins, its Chairman, Chief Executive Officer and largest shareholder, under three capital leases that expire in the year 2015. The original distribution center/office facility was occupied in 1985.

Under the three capital leases, dated April 1, 1985, November 1, 1989 and September 1, 1998, the Company paid Mr. Higgins an annual rent of \$2.3 million, \$2.2 million and \$2.2 million in Fiscal 2012, 2011 and 2010 respectively. Pursuant to the terms of the lease agreements, effective January 1, 2002 and every two years thereafter, rental payments will increase in accordance with the biennial increase in the Consumer Price Index. Under the terms of the lease agreements, the Company is responsible for property taxes, insurance and other operating costs with respect to the premises. Mr. Higgins does not have any future obligation for principal and interest. None of the leases contain any real property purchase options at the expiration of its term.

The Company leases one of its retail stores from Mr. Higgins under an operating lease. Annual rental payments under this lease were \$40,000 in Fiscal 2012, 2011 and 2010. Under the terms of the lease, the Company pays property taxes, maintenance and a contingent rental if a specified sales

**TRANS WORLD ENTERTAINMENT CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

level is achieved. Total additional charges for the store, including contingent rent, were approximately \$6,400, \$6,900 and \$6,800 in Fiscal 2012, 2011 and 2010 respectively.

**Note 11. Quarterly Financial Information (Unaudited)**

	Fiscal 2012 Quarter Ended				
	2012	February 2, 2013	October 27, 2012	July 28, 2012	April 28, 2012
	(\$ in thousands, except for per share amounts)				
Net sales.....	\$458,544	\$163,449	\$ 91,769	\$ 91,038	\$112,287
Gross profit.....	172,122	59,752	34,737	35,818	41,815
Net income (loss).....	<u>\$ 33,734</u>	<u>\$ 35,012</u>	<u>(\$2,188)</u>	<u>(\$1,886)</u>	<u>\$ 2,796</u>
Basic income (loss) per share.....	<u>\$ 1.07</u>	<u>\$ 1.11</u>	<u>(\$0.07)</u>	<u>(\$0.06)</u>	<u>\$ 0.09</u>
Diluted income (loss) per share.....	<u>\$ 1.06</u>	<u>\$ 1.09</u>	<u>(\$0.07)</u>	<u>(\$0.06)</u>	<u>\$ 0.09</u>

	Fiscal 2011 Quarter Ended				
	2011	January 28, 2012	October 29, 2011	July 30, 2011	April 30, 2011
	(\$ in thousands, except for per share amounts)				
Net sales .....	\$542,589	\$193,107	\$109,996	\$107,990	\$131,496
Gross profit .....	198,154	69,221	40,653	39,991	48,289
Net income (loss).....	<u>\$ 2,162</u>	<u>\$ 16,496</u>	<u>(\$4,510)</u>	<u>(\$7,277)</u>	<u>(\$2,547)</u>
Basic and diluted income (loss) per share ...	<u>\$ 0.07</u>	<u>\$ 0.52</u>	<u>(\$0.14)</u>	<u>(\$0.23)</u>	<u>(\$0.08)</u>

During the fourth quarter of Fiscal 2012, the Company recorded a gain on the sale of an asset of \$22.8 million. See Note 3 in the Notes to Consolidated Financial Statements for further detail regarding the gain.

**Index to Exhibits**  
**Document Number and Description**

**Exhibit No.**

- 3.1 Restated Certificate of Incorporation—incorporated herein by reference to Exhibit 3.1 to the Company’s Annual Report on Form 10-K for the year ended January 29, 1994. Commission File No. 0-14818.
- 3.2 Certificate of Amendment to the Certificate of Incorporation—incorporated herein by reference to Exhibit 3.1 to the Company’s Quarterly Report on Form 10-Q for the fiscal quarter ended October 29, 1994. Commission File No. 0-14818.
- 3.3 Certificate of Amendment to the Certificate of Incorporation—incorporated herein by reference to Exhibit 3.4 to the Company’s Annual Report on Form 10-K for the year ended January 31, 1998. Commission File No. 0-14818.
- 3.4 Amended By-Laws—incorporated herein by reference to Exhibit 3.4 to the Company’s Annual Report on Form 10-K for the year ended January 29, 2000. Commission File No. 0-14818.
- 3.5 Certificate of Amendment to the Certificate of Incorporation—incorporated herein by reference to Exhibit 3.5 to the Company’s Registration Statement on Form S-4, No. 333-75231.
- 3.6 Certificate of Amendment to the Certificate of Incorporation—incorporated herein by reference to Exhibit 3.6 to the Company’s Registration Statement on Form S-4, No. 333-75231.
- 3.7 Certificate of Amendment to the Certificate of Incorporation—incorporated herein by reference to Exhibit 4.2 to the Company’s Current Report on Form 8-K filed August 15, 2000. Commission File No. 0-14818.
- 3.8 Certificate of Amendment to the Certificate of Incorporation of—incorporated herein by reference to Exhibit 2 to the Company’s Current Report on Form 8-A filed August 15, 2000. Commission File No. 0-14818.
- 4.1 Credit Agreement dated January 5, 2006, between Trans World Entertainment Corporation and Bank of America N.A.—incorporated by reference to Exhibit 99.2 to the Company’s Current Report on Form 8-K filed January 10, 2006. Commission File No. 0-14818.
- 4.2 First Amendment to Credit Agreement between Trans World Entertainment Corporation and Bank of America N.A.—incorporated by reference to Exhibit 4.1 to the Company’s Current Report on Form 8-K filed March 29, 2006. Commission File No. 0-14818.
- 4.3 Second Amendment to Credit Agreement between Trans World Entertainment Corporation and Bank of America N.A.—incorporated by reference to Exhibit 4.1 to the Company’s Current Report on Form 8-K filed October 23, 2006. Commission File No. 0-14818.
- 4.4 Amended and Restated Credit Agreement between Trans World Entertainment Corporation and Bank of America N.A.—incorporated by reference to Exhibit 4.1 to the Company’s Current Report on Form 8-K filed April 15, 2010. Commission File No. 0-14818.
- 4.5 First Amendment to Credit Agreement between Trans World Entertainment Corporation and Wells Fargo; National Association dated May 4, 2012—incorporated by reference to Exhibit 4.1 to the Company’s Current Report on Form 8-K filed May 7, 2012. Commission File No. 0-14818.



**Exhibit No.**

- 4.6 Consent dated November 27, 2012, pursuant to Amended and Restated Credit Agreement, dated as of April 15, 2010 by and between Trans World Entertainment Corporation and Wells Fargo Bank, National Association - incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed November 27, 2012. Commission File No. 0-14818.
- 10.1 Lease, dated April 1, 1985, between Robert J. Higgins, as Landlord, and Record Town, Inc. and Trans World Music Corporation, as Tenant and Amendment thereto dated April 28, 1986—incorporated herein by reference to Exhibit 10.3 to the Company's Registration Statement on Form S-1, No. 33-6449.
- 10.2 Second Addendum, dated as of November 30, 1989, to Lease, dated April 1, 1985, among Robert J. Higgins, and Trans World Music Corporation, and Record Town, Inc., exercising five year renewal option—incorporated herein by reference to Exhibit 10.2 to the Company's Annual Report on Form 10-K for the year ended February 3, 1990. Commission File No. 0-14818.
- 10.3 Lease, dated November 1, 1989, between Robert J. Higgins, as Landlord, and Record Town, Inc. and Trans World Music Corporation, as Tenant—incorporated herein by reference to Exhibit 10.3 to the Company's Annual Report on Form 10-K for the year ended February 2, 1991. Commission File No. 0-14818.
- 10.5 Lease dated September 1, 1998, between Robert J. Higgins, as Landlord, and Record Town, Inc. and Trans World Music Corporation, as Tenant, for additional office space at 38 Corporate Circle—incorporated herein by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended October 31, 1998. Commission File No. 0-14818.
- 10.6 Trans World Music Corporation 1990 Stock Option Plan for Non-Employee Directors, as amended and restated—incorporated herein by reference to Annex A to Trans World's Definitive Proxy Statement on Form 14A filed as of May 19, 2000. Commission File No. 0-14818.
- 10.7 Trans World Entertainment Corporation 1994 Stock Option Plan—incorporated herein by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended July 30, 1994. Commission File No. 0-14818.
- 10.8 Trans World Entertainment Corporation 1998 Stock Option Plan—incorporated herein by reference to Annex B to Trans World's Definitive Proxy Statement on Form 14A filed as of May 7, 1998. Commission File No. 0-14818.
- 10.9 Trans World Entertainment Corporation 1999 Stock Option Plan—incorporated herein by reference to Annex A to Trans World's Definitive Proxy Statement on Form 14A filed as of May 7, 1998. Commission File No. 0-14818.
- 10.10 Form of Indemnification Agreement dated May 1, 1995 between the Company and its officers and directors incorporated herein by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended April 29, 1995. Commission File No. 0-14818.
- 10.11 Trans World Entertainment Corporation 2002 Stock Option Plan—incorporated herein by reference to Annex A to Trans World's Definitive Proxy Statement on Form 14A filed as of May 23, 2002. Commission File No. 0-14818.
- 10.12 Trans World Entertainment Corporation Supplemental Executive Retirement Plan, as amended—incorporated herein by reference to Exhibit 10.1 to the Company's Form 8-K filed on July 16, 2012. Commission File No. 0-14818.
- 10.13 Employment Agreement, dated as of December 26, 2008, between the Company and Robert J. Higgins. Incorporated herein by reference to Exhibit 10.1 to the Company's Form 8-K filed on December 29, 2008. Commission File No. 0-14818.

**Exhibit No.**

- 10.14 Trans World Entertainment Corporation 2005 Long Term Incentive and Share Award Plan incorporated herein by reference to Appendix A to Trans World Entertainment Corporation's Definitive Proxy Statement on Form 14A filed as of May 11, 2005. Commission File No. 0-14818.
- 10.15 Trans World Entertainment Corporation Executive Officers Bonus Plan—incorporated herein by reference to Appendix A to Trans World Entertainment Corporation's Definitive Proxy Statement on Form 14A filed as of May 20, 2009. Commission File No. 0-14818.
- \*21 Significant Subsidiaries of the Registrant.
- \*23 Consent of KPMG LLP.
- \*31.1 Certification of Chief Executive Officer dated April 18, 2013, relating to the Registrant's Annual Report on Form 10-K for the year ended February 2, 2013, pursuant to Rule 13a-14(a) or Rule 15a-14(a).
- \*31.2 Certification of Chief Financial Officer dated April 18, 2013, relating to the Registrant's Annual Report on Form 10-K for the year ended February 2, 2013, pursuant to Rule 13a-14(a) or Rule 15a-14(a).
- \*\*32 Certification of Chief Executive Officer and Chief Financial Officer of Registrant, dated April 18, 2013, pursuant to 18 U.S.C. Section 1350, as adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 relating to the Registrant's Annual Report on Form 10-K for the year ended February 2, 2013.

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\* Filed herewith

\*\* Furnished herewith

**TRANS WORLD ENTERTAINMENT CORPORATION**  
**SIGNIFICANT SUBSIDIARIES OF THE REGISTRANT**

<u>Name of Significant Subsidiary</u>	<u>State of Incorporation</u>	<u>Subsidiary Trade Names</u>
Record Town, Inc.	New York	Record Town, Inc. CD World f.y.e. Games Manifest Record and Tape Traders Streetside Records Specs Spin Street fye.com warehouse.com secondspin.com
Record Town USA, LLC	Delaware	Record Town USA, LLC f.y.e. (For Your Entertainment) Coconuts Saturday Matinee f.y.e. movies Second Spin Wherehouse Music Suncoast Motion Pictures Sam Goody
Record Town Utah, LLC	New York	Record Town Utah, LLC f.y.e. Superstore
Trans World New York, LLC	New York	Trans World New York, LLC
Trans World Florida, LLC	Florida	Trans World Florida, LLC

**Consent of Independent Registered Public Accounting Firm**

The Board of Directors  
Trans World Entertainment Corporation:

We consent to incorporation by reference in the registration statements (Nos. 33-40399, 33-51094, 33-51516, 33-59319, 333-75231, 333-81685, 333-101532, and 333-128210) on Form S-8 of our report dated April 18, 2013, with respect to the consolidated balance sheets of Trans World Entertainment Corporation and subsidiaries as of February 2, 2013, and January 28, 2012, and the related consolidated statements of operations, comprehensive income (loss), shareholders' equity and cash flows for each of the fiscal years in the three-year period ended February 2, 2013 which report appears in the Annual Report on Form 10-K of Trans World Entertainment Corporation and subsidiaries for the fiscal year ended February 2, 2013.

/s/ KPMG LLP

Albany, New York  
April 18, 2013

**CHIEF EXECUTIVE OFFICER CERTIFICATION  
PURSUANT TO SECTION 302 OF SARBANES OXLEY ACT 2002**

I, Robert J. Higgins, certify that:

- (1) I have reviewed this report on Form 10-K of Trans World Entertainment Corporation (“the Registrant”);
- (2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- (3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
- (4) The Registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15(d)-15(f)) for the Registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the Registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the Registrant’s internal control over financial reporting that occurred during the Registrant’s most recent fiscal quarter (the Registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant’s internal control over financial reporting; and
- (5) The Registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant’s auditors and the audit committee of the Registrant’s board of directors(or persons performing equivalent functions):
  - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant’s ability to record, process, summarize and report financial information; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant’s internal control over financial reporting.

Dated: April 18, 2013

\_\_\_\_\_  
/s/ ROBERT J. HIGGINS  
(Chairman and Chief Executive Officer  
Trans World Entertainment Corporation)

**CHIEF FINANCIAL OFFICER CERTIFICATION  
PURSUANT TO SECTION 302 OF SARBANES OXLEY ACT 2002**

I, John Anderson, certify that:

- (1) I have reviewed this report on Form 10-K of Trans World Entertainment Corporation (“the Registrant”);
- (2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- (3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
- (4) The Registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15(d)-15(f)) for the Registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the Registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the Registrant’s internal control over financial reporting that occurred during the Registrant’s most recent fiscal quarter (the Registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant’s internal control over financial reporting; and
- (5) The Registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant’s auditors and the audit committee of the Registrant’s board of directors(or persons performing equivalent functions):
  - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant’s ability to record, process, summarize and report financial information; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant’s internal control over financial reporting.

Dated: April 18, 2013

\_\_\_\_\_  
/s/ JOHN ANDERSON  
(Chief Financial Officer  
Trans World Entertainment Corporation)

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER  
PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of Trans World Entertainment Corporation (the “Registrant”) on Form 10-K for the period ending February 2, 2013 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), we, Robert J. Higgins, Chairman and Chief Executive Officer of the Registrant and John Anderson, Chief Financial Officer of the Registrant, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to 906 of the Sarbanes-Oxley Act of 2002, that, to the best of our knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

/s/ ROBERT J. HIGGINS

**Chairman and Chief Executive Officer**

April 18, 2013

/s/ JOHN ANDERSON

**Chief Financial Officer**

April 18, 2013

This certification shall not be deemed to be “filed” for the purpose of Section 18 of the Securities Exchange Act of 1934, as amended, and will not be incorporated by reference into any registration statement filed under the Securities Act of 1933, as amended, unless specifically identified as being incorporated therein by reference.

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to Trans World Entertainment and will be retained by Trans World Entertainment and furnished to the Securities and Exchange Commission or its staff upon request.



**TRANS WORLD ENTERTAINMENT CORPORATION**  
**38 Corporate Circle**  
**Albany, New York 12203**  
**(518) 452-1242**

**NOTICE OF ANNUAL MEETING OF SHAREHOLDERS**

Date and Time	Tuesday, July 2, 2013, at 10:00 A.M., EDT
Place	Albany Country Club 300 Wormer Road Voorheesville, New York 12186
Items of Business	(1) To elect six Directors to serve one year terms and until their successors are chosen and qualified;  (2) Advisory Vote to Approve Named Executive Officer Compensation;  (3) Advisory Vote on Frequency of Holding Future Advisory Votes on Executive Compensation;  (4) To transact such other business as may properly come before the meeting or any adjournment or adjournments thereof.
Record Date	Shareholders of record as of May 20, 2013 are eligible to vote.
Proxy Voting	A proxy and return envelope, not requiring postage if mailed in the United States, are enclosed for your convenience. Please complete and return your proxy card as promptly as possible. All shareholders are cordially invited to attend the Annual Meeting. Whether or not you plan to attend the meeting, your vote is important. Prompt return of the proxy will assure a quorum is present at the annual meeting and save the Company expense.

By order of the Board of Directors,

Edwin J. Sapienza,  
Secretary

May 31, 2013



**TRANS WORLD ENTERTAINMENT CORPORATION**  
**38 Corporate Circle**  
**Albany, New York 12203**  
**(518) 452-1242**

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**PROXY STATEMENT**

This Proxy Statement is furnished to the shareholders of Trans World Entertainment Corporation, a New York corporation (the “Company”), in connection with the solicitation of proxies by the Board of Directors for use at the Annual Meeting of Shareholders of the Company to be held on July 2, 2013 (the “Annual Meeting”), and any adjournment or adjournments thereof. A copy of the notice of meeting accompanies this Proxy Statement. It is anticipated that the mailing of this Proxy Statement and the form of proxy/voting instruction card will commence on May 31, 2013.

As permitted by rules of the Securities and Exchange Commission (“SEC”), we are making our proxy material, which includes our notice of annual meeting, proxy statement and Annual Report on Form 10-K, available to our shareholders over the Internet. An electronic version of this proxy statement and the Company’s Annual Report on Form 10-K are available at [www.envisionreports.com/TWMC](http://www.envisionreports.com/TWMC).

**VOTING SECURITIES**

The Company has only one class of voting securities, its common stock, par value \$.01 per share (the “Common Stock”). On May 20, 2013, the record date, 33,063,582 shares of Common Stock were outstanding. Each shareholder of record at the close of business on the record date will be entitled to one vote for each share of Common Stock owned on that date, as to each matter presented at the Annual Meeting.

**QUORUM AND TABULATION OF VOTES**

The By-Laws of the Company provide that a majority of the shares of our Common Stock entitled to vote at the Annual Meeting, present in person or by proxy, shall constitute a quorum at the Annual Meeting of Shareholders of the Company. An inspector from Computershare; appointed by the Company will determine the presence of a quorum and will certify and tabulate the votes. Shares of Common Stock represented by a properly signed and returned proxy are considered as present at the Annual Meeting for purposes of determining a quorum. Shareholders of record who are present at the Annual Meeting, in person or by proxy, and who abstain from voting, including brokers holding customers’ shares of record who cause abstentions to be recorded at the Annual Meeting, will be included in the number of shareholders present at the Annual Meeting for purposes of determining whether a quorum is present. However, these shares will not be taken into account in determining the outcome of any of the proposals. A shareholder (including a broker) who does not give authority to a proxy to vote, or withholds authority to vote, on a certain proposal will not be considered present and entitled to vote on that proposal. A broker non-vote occurs when a bank or broker holding shares of a beneficial stockholder does not vote on a particular proposal because it has not received instructions from the beneficial stockholder and the bank or broker does not have discretionary voting power for that particular item.

If you are a beneficial owner and hold your shares in the name of a bank, broker or other holder of record and do not return the voting instruction card, the broker or other nominee will vote your shares on each matter at the Annual Meeting for which he or she has the requisite discretionary authority. If a shareholder does not give instructions to its broker as to how to vote the shares, the broker has authority under New York Stock Exchange rules to vote those shares for or against “routine” proposals. Brokers cannot vote on their customers’ behalf on “non-routine” proposals. Under these rules, “Item 1—Election of Directors,” and “Item 2—Advisory Vote on Executive Compensation” and “Item 3—Vote on the Frequency of Holding Future Advisory Votes on Executive Compensation” are considered “non-routine” proposals. We are subject to these rules

even though the shares of our common stock are traded on the NASDAQ Global Select Market. If a broker votes shares that are unvoted by its customers for or against a “routine” proposal, these shares are counted for the purpose of establishing a quorum and also will be counted for the purpose of determining the outcome of “routine” proposals. If a broker does not receive voting instructions as to a non-routine proposal, or chooses to leave shares unvoted on a routine proposal, a “broker non-vote” occurs and those shares will not be counted for determining the outcome of those proposals. Shares that are subject to broker non-votes are considered not entitled to vote on the particular proposal, and effectively reduce the number of shares needed to approve that proposal.

Pursuant to the Company’s By-Laws, “Item 1—Election of Directors” is determined by the affirmative vote of a plurality of the shares of our Common Stock present at the Annual Meeting, in person or by proxy, and entitled to vote on the proposal. Under applicable New York law, in determining whether such nominees have received the requisite number of affirmative votes, abstentions will have no effect on the outcome of the vote. With respect to the election of directors, votes may be cast “for” all nominees, “withheld” from all nominees, or “withheld” specifically from identified nominees. Brokers do not have discretionary voting power on this proposal.

A proxy may be revoked at any time prior to the voting at the Annual Meeting by submitting a later dated proxy (including a proxy by telephone), by giving timely written notice of such revocation to the Secretary of the Company or by attending the Annual Meeting and voting in person. However, if you hold any shares of Common Stock in “street name,” (that is through a bank, broker or other nominee) you may not vote these shares in person at the Annual Meeting unless you bring with you a legal proxy from the holder of record of such shares.

The Company will pay the costs of soliciting, preparing, printing and mailing this Notice of Annual Meeting of Stockholders and Proxy Statement, the enclosed proxy card and the Company’s 2012 Annual Report to Stockholders. In accordance with the regulations of the SEC, we also reimburse brokerage firms and other custodians, nominees and fiduciaries for their reasonable expenses incurred in connection with their forwarding of proxies and proxy solicitation materials to beneficial owners of our Common Stock as of the record date. The solicitation of proxies will be conducted primarily by mail, but may also include the Internet, telephone, facsimile or oral communications by directors, officers or regular employees of the Company acting without special compensation. The Company will also request persons, firms and corporations holding shares in their names, or in the names of their nominees, which are beneficially owned by others, to send or cause to be sent proxy materials to, and obtain proxies from, such beneficial owners, and, on request, will reimburse such holders for their reasonable expenses in so doing.

## PRINCIPAL SHAREHOLDERS

The only persons known to the Board of Directors to be the beneficial owners of more than five percent of the outstanding shares of the Common Stock as of May 20, 2013, the record date, are indicated below:

<u>Name and Address of Beneficial Owner</u>	<u>Amount and Nature of Beneficial Ownership</u>	<u>Percent of Class</u>
Robert J. Higgins ..... 38 Corporate Circle Albany, New York 12203	17,135,675 <sup>(1)</sup>	49.6%
Lloyd I. Miller, III ..... 4550 Gordon Drive Naples, Florida 34102	5,727,596 <sup>(2)</sup>	17.3%
Dimensional Fund Advisors Inc. .... 1299 Ocean Avenue, 11th Floor Santa Monica, California 90401	2,448,928 <sup>(3)</sup>	7.4%
Nantahala Capital Management, LLC..... 100 First Stamford Place, 2nd Floor Stamford, CT 06902	1,946,888 <sup>(4)</sup>	5.9%
Blue Shore Capital Management..... 101 Eisenhower Parkway Roseland, NJ 07068	1,609,396 <sup>(5)</sup>	4.9%

- (1) Information is as of May 20, 2013, as provided by the holder. Includes 1,475,000 shares that may be acquired within 60 days of May 20, 2013, 900,550 shares owned by the wife of Robert J. Higgins and 137,500 shares owned by a foundation controlled by Robert J. Higgins, and excludes 814,761 shares owned by certain other family members of Robert J. Higgins who do not share his residence. Mr. Higgins disclaims beneficial ownership with respect to those shares owned by family members other than his wife.
- (2) Based on Form 13G/A, filed February 14, 2012 by Lloyd Miller, III.
- (3) Based on Form 13G/A, filed February 11, 2013, by Dimensional Fund Advisors Inc.
- (4) Based on Form 13G/A, filed February 14, 2013 by Nantahala Capital Management, LLC.
- (5) Based on Form 13G, filed March 14, 2013 by Blue Shore Capital Management.

Mr. Higgins, who beneficially owns 17,135,675 shares of Common Stock as of the record date (approximately 50.4% of all outstanding shares), has advised the Company that he presently intends to vote for the election of the nominees for Directors named under “Item 1—Election of Directors” and for “Item 2—Advisory Vote on Executive Compensation” and “Item 3—Vote on the Frequency of Holding Future Advisory Votes on Executive Compensation”

### **Item 1. Election of Directors**

The Board of Directors (also referred to herein as the “Board”) has nominated six candidates for election as directors to hold office (subject to the Company’s By-Laws) for a one-year term expiring at the 2014 annual meeting of stockholders (the “2014 Meeting”) and until their successors have been elected and qualified.

The nominees will be elected by a plurality vote of the outstanding shares of Common Stock present and entitled to vote at the Annual Meeting.

If the nominees listed below should become unavailable for any reason, which management does not anticipate, the proxy will be voted for any substitute nominee who may be selected by the Nominating and Corporate Governance Committee of the Board prior to, or at the Annual Meeting or if no substitute is selected prior to or at the Annual Meeting, for a motion to reduce the membership of the Board to the number of nominees available. The information concerning the nominees and their security holdings has been furnished by them to the Company.

The biographies of each of the Directors contain applicable information regarding the person’s service as a director, business, educational, and other professional experience, director positions held currently or at any time during the last five years, and the experiences, qualifications, attributes or skills that cause the Board to determine that the person should serve as a director for the Company. The Company believes that the backgrounds and qualifications of its Directors, considered as a

group, should provide the Company and Board with diverse business and professional capabilities, along with the experience, knowledge and other abilities that will allow the Board to fulfill its responsibilities.

### **Nominees for Election as Directors**

**Robert J. Higgins**, Chairman of the Board, founded the Company in 1972, and he has participated in its operations since 1973. Mr. Higgins has served as Chairman and Chief Executive Officer of the Company for more than the past five years. He is also the Company's principal shareholder. See "PRINCIPAL SHAREHOLDERS." As founder and Chief Executive Officer of the Company for nearly 40 years, Mr. Higgins brings an extraordinary understanding of our Company's business, history and organization. With his day-to-day leadership and intimate knowledge of our business and operations, Mr. Higgins provides the board with invaluable insight into the operations of our Company.

**Isaac Kaufman**, a Certified Public Accountant, has been Chief Financial Officer and Senior Vice President of Advanced Medical Management Inc., a manager of medical practices and an outpatient surgical center, since September 1998. Mr. Kaufman serves as a Director of Kindred Healthcare, Inc., which operates nursing centers and long-term acute care hospitals and Hanger Inc., which operates orthotics and prosthetic patient care services. Mr. Kaufman's key experience, qualifications and skills include accounting, auditing, disclosure, risk management and finance matters, specifically his experience as the chairperson of the audit committee of Kindred Healthcare, Inc. and Hanger Inc., as well as his experience in specialty retailing particularly in distributed retailing business models. Mr. Kaufman brings over 45 years of cumulative board experience.

**Robert E. Marks** has been the President of Marks Ventures, LLC, a private equity investment firm since 1994. Mr. Marks is currently a director of Denny's Corporation ("Denny's") and served as Chairman of the Board of Directors of Denny's from 2004 to 2006; a director of Emeritus Corporation, as well as a member of the Board of Trustees of the Fisher House Foundation, a member of the Board of Trustees of the Greenwich, Connecticut Public Library, a member of the Board of Trustees of the Greenwich Field Club, a member of the Board of Trustees of The International Rescue Committee and a member of Stanford University's Alumni Committee on Trustee Nominations. Mr. Marks has extensive finance, investment and executive compensation experience to share with the Board.

**Dr. Joseph G. Morone** has been the President and CEO of Albany International Corp since January 2006 and President since August 2005. From August 1997 to July 2005 he was the President of Bentley College. Previously, Dr. Morone was the Dean of Rensselaer Polytechnic Institute's Lally School of Management and Technology from July 1993 to July 1997. Prior to his appointment as dean, Dr. Morone held the Andersen Consulting Professorship of Management and was Director of the School of Management's Center for Science and Technology Policy. Before joining the School of Management in 1988, Dr. Morone was a senior associate for the Keyworth Company, a consulting firm specializing in technology management and science policy. Dr. Morone also served in the White House Office of Science and Technology Policy and spent seven years at General Electric Company's Corporate Research and Development. Dr. Morone also serves on the Board of Directors of Albany International Corp. Dr. Morone has executive leadership experience at public companies and academic institutions, with an expertise in risk management and strategic planning.

**Michael Nahl** was Executive Vice President and Chief Financial Officer of Albany International Corp. from April 2005 until his retirement in September 2009. Mr. Nahl is currently a director of Lindsay Corporation and was a member of JPMorgan Chase and Company's Regional Advisory Board from 1996 through 2010. Mr. Nahl has broad and thorough knowledge on accounting, disclosure, risk management, auditing and finance matters, as well as operational and strategic experience to share with our Board.

**Michael B. Solow** is the Co-Chairman and Managing Partner of Kaye Scholer LLP, an international law firm based in New York City, where he has practiced since January 2001 and is currently a member of the firm's Executive Committee. Prior to joining Kaye Scholer LLP, Mr. Solow was a Partner and Practice Manager for the Financial Services Practice at Hopkins & Sutter,

a Chicago, Illinois law firm. Mr. Solow has previously served on other corporate boards, including Camelot Music, Inc. Mr. Solow provides the Board with extensive legal and management experience, particularly his expertise in corporate finance and his experience in law firm management.

### **Item 2. Advisory Vote to Approve Named Executive Officer Compensation**

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”) allows our shareholders to vote to approve, on an advisory (non-binding) basis, the compensation of our named executive officers as disclosed in this proxy statement in accordance with SEC rules.

The objectives of our compensation programs are to attract, motivate, retain and reward executives and employees who will make substantial contributions toward the Company’s meeting the financial, operational and strategic objectives that we believe will build substantial value for the Company’s shareholders.

We are requesting shareholder approval of the compensation of our named executive officers pursuant to the compensation disclosure rules of the SEC, including the “Compensation Discussion and Analysis,” the compensation tables and any related material disclosed in this proxy statement. This vote is not intended to address any one specific item of compensation, but instead the overall compensation of our named executive officers and the policies and practices described in this proxy statement.

This vote is advisory and therefore not binding on the Company, the Compensation Committee of the Board of Directors or the Board. The Board and the compensation committee value the views of our shareholders and, to the extent there is any significant vote against the named executive officer compensation as disclosed in this proxy statement, we will consider those shareholders’ concerns and will evaluate whether any actions are necessary to address those concerns.

### **Item 3. Advisory Vote on Frequency of Holding Future Advisory Votes on Executive Compensation**

The Dodd-Frank Act also allows our shareholders to vote, on an advisory (non-binding) basis, on how frequently they would like to cast an advisory vote on the compensation of our named executive officers as disclosed in accordance with the compensation disclosure rules of the SEC. By voting on this proposal, shareholders may indicate whether they would prefer an advisory vote on named executive officer compensation every year, every other year or every third year.

After careful consideration of the alternatives, the Board believes that conducting an advisory vote on executive compensation on a three year basis is appropriate for the Company and its shareholders at this time. The Board will carefully consider the outcome of the vote when making future decisions regarding the frequency of advisory votes on executive compensation. However, because this vote is advisory and not binding, the Board may decide that it is in the best interests of the Company and its shareholders to hold an advisory vote more or less frequently than the alternative that has been selected by our shareholders.

### **Executive Officers**

The Company’s executive officers (other than Mr. Higgins whose biographical information is included under “Item 1 - Election of Directors” herein) are identified below.

**John Anderson** has been Chief Financial Officer of the Company since February 2013. Prior to being named Chief Financial Officer, Mr. Anderson was Acting Chief Financial Officer beginning July 2012. Prior to that, Mr. Anderson served in positions of increasing responsibility at Trans World for over 18 years, most recently serving as Controller since September 2006.

**Bruce J. Eisenberg** has been Executive Vice President of Real Estate since May 2001. He added the title of Executive Vice President of Store Operations in 2011. He joined the Company in August of 1993 as Vice President of Real Estate and was named Senior Vice President of Real

Estate in May 1995. Prior to joining the Company, Mr. Eisenberg was responsible for leasing, finance and construction of new regional mall development at The Pyramid Companies.

**Mike Manske** has been Senior Vice President of Merchandising and Marketing since February 2013. Prior to adding responsibility for Marketing, Mr. Manske served as Senior Vice President of Merchandising starting July 2012. Prior to joining the Company, he served as the Vice President of Global Merchandising for Best Buy Co., Inc. from 2008 to 2012.

**Stephen J. Murray** has been Senior Vice President IT and Supply Chain since February 2013. He was named Vice President IT and Supply Chain in December of 2010. Prior to joining the Company he served as Vice President of IT for Bernie's TV and Appliances from 2007 to 2010. Previously, Mr. Murray was the Vice President of IT for Platform Learning and Vice President of Application Development for Bed Bath and Beyond for six years.

## EQUITY OWNERSHIP BY DIRECTORS AND EXECUTIVE OFFICERS

The following table sets forth the beneficial ownership of Common Stock as of May 20, 2013, by each Director and Named Executive Officer of the Company and all Directors and executive officers as a group. All shares listed in the table are owned directly by the named individuals, unless otherwise indicated therein. The Company believes that the beneficial owners have sole voting and investment power over their shares, except as otherwise stated or as to shares owned by spouses.

Name	Positions With the Company	Age	Year First Elected as Director/ Officer	Direct Ownership	Shares that may be acquired within 60 days of May 20, 2013	Total Shares Beneficially Owned	Percent of Class
Robert J. Higgins	Chairman of the Board and Chief Executive Officer	72	1973	15,660,675 <sup>(1)</sup>	1,475,000	17,135,675	49.6%
Isaac Kaufman	Director	66	1991	34,500	72,891	107,391	*
Robert E. Marks	Nominee for Director	61	2012	—	—	—	*
Dr. Joseph G. Morone	Director	60	1997	124,088	—	124,088	*
Michael Nahl	Director	70	2011	11,520	3,750	15,270	*
Michael B. Solow	Director	54	1999	82,089	9,655	91,744	*
John Anderson	Chief Financial Officer	44	2012	—	—	*	*
Bruce J. Eisenberg	Executive Vice President— Real Estate	53	1995	19,924	235,000	254,924	*
Mike Manske	SVP — Merchandising SVP — Supply Chain and IT	44	2012	—	—	—	*
Steve Murray	IT	51	2011	—	25,000	25,000	*
All Directors and Executive Officers as a group (10 persons)				15,932,796	1,821,296	17,754,092	50.9%

\* Less than 1% of issued and outstanding common shares

- (1) Includes 900,550 shares owned by the wife of Robert J. Higgins and 137,500 shares owned by a foundation controlled by Robert J. Higgins, and excludes 814,761 shares owned by certain other family members of Robert J. Higgins who do not share his residence. Mr. Higgins disclaims beneficial ownership with respect to those shares owned by family members other than his wife.

## CORPORATE GOVERNANCE

### The Board of Directors

#### *Meetings and Attendance*

The Board of Directors held 6 meetings during the 2012 fiscal year. All of the Directors attended greater than 75% of the aggregate of: (i) the total number of meetings of the Board of Directors, and (ii) the total number of meetings held by all committees of the Board on which such Director served.

It is the policy of the Board that all Directors should be present at Company's Annual Meeting of Shareholders. Five of the six Directors then in office and standing for election attended the 2012 Annual Meeting of Shareholders.

#### *Code of Business Ethics*

The Board of Directors has adopted a Code of Conduct applicable to the Company's officers, employees, Directors and Consultants. The Code of Ethics is available on the Company's website, [www.twec.com](http://www.twec.com). A copy of the Code of Ethics is available in print to any stockholder who requests them, in writing to the Company's Corporate Secretary, Trans World Entertainment Corporation, 38 Corporate Circle, Albany, NY, 12203.

#### *Guidelines for Evaluating Independence of Directors*

The Board has determined that all of the Directors, other than Mr. Higgins, are independent directors in accordance with the standards of the NASDAQ Stock Market and as described below.

The Nomination and Governance Committee as well as the Board annually reviews relationships that Directors may have with the Company to make a determination of whether there are any material relationships that would preclude a Director being independent.

The standards relied upon by the Board in affirmatively determining whether a director is “independent,” in compliance with the rules of the NASDAQ Stock Market, are comprised, in part, of those objective standards set forth in the NASDAQ rules. The Board is responsible for ensuring that independent directors do not have a material relationship with the Company or its affiliates or any executive officer of the Company or his or her affiliates.

### ***Presiding Director***

The Board of Directors does not have a policy regarding the separation of the roles of Chief Executive Officer and Chairman of the Board of Directors as the Board of Directors believes it is in the best interest of the Company to make that determination through an ongoing evaluation of the position and direction of the Company and the membership and composition of the Board of Directors. The current Board of Directors has determined that having the roles of Chief Executive Officer and Chairman of the Board combined is in the best interest of the Company and its’ shareholders at this time. The current Chairman and Chief Executive Officer, Robert J. Higgins, is the founder of the Company and has been the CEO for over 40 years. The Board of Directors believes that the current structure makes the best use of the Chief Executive Officer’s extensive knowledge of the Company and its industry, and fosters greater communication between the Company’s management and the Board of Directors.

The non-management directors annually elect one independent director to be the Presiding Director. Dr. Morone currently serves as the Presiding Director. The Presiding Director’s responsibilities are to:

- Preside over executive sessions of the non-management directors and at all meetings at which the Chairman is not present;
- Call meetings of the non-management directors as he or she deems necessary;
- Serve as liaison between the Chairman and the non-management directors;
- Approve agendas and schedules for Board meetings;
- Advise the Chairman of the Board’s informational needs;
- Communicate goals and objectives to the Chairman and Chief Executive Officer and the results of the evaluation of his performance; and
- Be available for consultation and communication if requested by major stockholders.

### **Committees of the Board of Directors**

#### ***The Audit Committee***

The Board of Directors has an Audit Committee whose current members are: Isaac Kaufman (Chairman), Robert Marks, Dr. Joseph Morone, and Michael Nahl. These Directors are, in the opinion of the Board of Directors, “independent” (as defined under the standards of the NASDAQ Stock Market) of management and free of any relationship that would interfere with their exercise of independent judgment as members of the Audit Committee. The Board of Directors has determined that Isaac Kaufman is both independent and qualified as an Audit Committee financial expert as such term is defined under the rules and regulations promulgated by the Securities and Exchange Commission and applicable to this Proxy Statement. The Audit Committee held four meetings during the 2012 fiscal year. The Audit Committee’s responsibilities consist of recommending the selection of independent accountants, reviewing the scope of the audit conducted by such accountants, as well as the audit itself, and reviewing the Company’s audit activities and matters concerning financial reporting, accounting and audit procedures, related party transactions and policies generally. The Audit Committee was established in accordance with Section 3(a)(58)(A) of the Securities Exchange Act of 1934.



### ***The Compensation Committee***

The Board of Directors has a Compensation Committee, consisting solely of independent Directors, whose current members are: Michael Solow (Chairman), Isaac Kaufman, Dr. Joseph Morone and Michael Nahl. The Compensation Committee held two meetings during the 2012 fiscal year. The Compensation Committee formulates and gives effect to policies concerning salary, compensation, stock options and other matters concerning employment with the Company. The processes and procedures used for the consideration and determination of executive compensation are described in the section of this Proxy captioned "Compensation Overview." The Board of Directors has adopted a written charter for the Compensation Committee, a copy of which is attached as Appendix A to this proxy.

### ***The Nominating and Corporate Governance Committee***

The Board of Directors has a Nominating and Corporate Governance Committee, consisting solely of independent Directors, whose current members are: Dr. Joseph Morone (Chairman), Isaac Kaufman, Robert Marks, Michael Nahl, and Michael Solow. The Nominating and Corporate Governance Committee held one meeting during the 2012 fiscal year. The Nominating Committee develops qualification criteria for Board members; interviews and screens individuals qualified to become Board members in order to make recommendations to the Board; and oversees the evaluation of executive management. The Committee seeks to select a Board that is strong in its collective knowledge of and diversity of skills and experience concerning retail operations, accounting and finance, management and leadership, vision and strategy, risk assessment and corporate governance. The Board of Directors has adopted a written charter for the Nominating and Corporate Governance Committee, a copy of which is attached as Appendix B to this proxy.

The Nominating and Corporate Governance Committee will consider nominations submitted by Shareholders. To recommend a nominee, a Shareholder should write to the Company's Secretary. To be considered by the Nominating and Corporate Governance Committee for nomination and inclusion in the Company's Proxy Statement for its 2014 Annual Meeting of Shareholders, a Shareholder recommendation for a Director must be received by the Company's Secretary no later than January 30, 2014. Any recommendation must include (i) the name and address of the candidate, (ii) a brief biographical description, including his or her occupation for at least the last five years, and a statement of the qualifications of the candidate, taking into account the qualification requirements summarized above, and (iii) the candidate's signed consent to be named in the Proxy Statement and to serve as a Director if elected. The Nominating and Corporate Governance Committee may seek additional biographical and background information from any candidate which, to be considered must be received on a timely basis.

The process followed by the Nominating and Corporate Governance Committee to identify and evaluate candidates includes requests to Board members and others for recommendations, including a search firm or outside consultant, meetings from time to time to evaluate biographical information and background material relating to potential candidates and interviews of selected candidates by members of the Nominating and Corporate Governance Committee and the Board. Assuming the appropriate biographical and background material is provided for candidates submitted by Shareholders, the Nominating and Corporate Governance Committee will evaluate those candidates by following substantially the same process, and applying substantially the same criteria, as for candidates submitted by Board members. While the Company does not have a formal diversity policy for Board of Director membership, the Nominating and Corporate Governance Committee and the Board of Directors, as a whole, seeks nominees or candidates to serve as directors that represent a variety of backgrounds and experience that will enhance the quality of the Board of Director's deliberations and decisions. The Nominating and Corporate Governance Committee considers, among other factors, diversity with respect to viewpoint, skills and experience in its evaluation of candidates for Board of Director membership. Such diversity considerations are discussed by the Nominating and Corporate Governance Committee in connection with the general qualifications of each potential nominee. The Nominating and Corporate Governance Committee did not receive any nominations from Shareholders for the 2013 Annual Meeting.

### ***Board's Role in Risk Oversight***

The Board has an active role, as a whole and also at the committee level, in overseeing management of the Company's risks. The Board regularly reviews information regarding the Company's credit, liquidity, and operations, as well as the risks associated with each. The Compensation Committee is responsible for overseeing the management of risks relating to the Company's executive compensation plans and arrangements. The Audit Committee oversees management of financial risks and potential conflicts of interest. The Nominating and Corporate Governance Committee manages risks associated with the independence of the Board. While each committee is responsible for evaluating certain risks and overseeing the management of such risks, the entire Board is regularly informed through committee reports about such risks.

### **Communications with the Board of Directors**

The Board has established a process for Shareholders to communicate with members of the Board. The Chairman of the Nominating and Corporate Governance Committee, with the assistance of the Company's Secretary, will be primarily responsible for monitoring communications from Shareholders and providing copies or summaries of such communications to the other Directors, as he or she considers appropriate. Communications will be forwarded to all Directors if they relate to appropriate matters and may include suggestions or comments from the Chairman of the Nominating and Corporate Governance Committee. Any such communication must state the number of shares beneficially owned by the shareholder making the communication. In general, communications relating to corporate governance and long-term corporate strategy are more likely to be forwarded than communications relating to personal grievances and matters as to which the Company tends to receive repetitive or duplicative communications. Shareholders who wish to send communications to the Board may do so by writing to:

Dr. Joseph Morone  
Chairman of the Nominating and Corporate Governance Committee  
c/o the Company's Secretary  
Trans World Entertainment Corporation  
38 Corporate Circle  
Albany, New York 12203

### **Compensation of Directors**

<u>Name</u>	<u>Fees Earned or Paid in Cash (\$) <sup>(2)</sup></u>	<u>Option Awards (\$) <sup>(3)</sup></u>	<u>Total Compensation (\$)</u>
Robert J. Higgins <sup>(1)</sup> .....	—	—	—
Isaac Kaufman.....	124,500	—	124,500
Robert Marks.....	15,799	29,100	44,899
Dr. Joseph G. Morone.....	114,500	—	114,500
Michael Nahl .....	109,500	—	109,500
Bryant Riley .....	91,201	—	91,201
Michael B. Solow .....	111,000	—	111,000

- (1) Although Mr. Higgins also serves as a member of the Board, he does not receive any additional compensation for such service. See "Summary Compensation Table."
- (2) Fees earned reflect the amount of cash received for the annual retainer, Board and committee meeting fees and cash received in lieu of Deferred Shares.
- (3) Amount represents the grant date fair value as computed in accordance with Accounting Standards Codification Topic 718, relating to the grant of stock options to a director in 2012. See Note 8 to the Consolidated Financial Statements in the Company's 2012 Annual Report on Form 10-K for the assumptions made in determining the value. Effective July 12, 2012, 15,000 stock options were awarded to Mr. Marks. The amount set forth in the table above does not necessarily reflect the value that will ultimately be realized with respect to the award.

*Cash Compensation.* Each Director who is not a salaried employee of the Company receives a \$12,500 retainer per annum plus a \$2,000 attendance fee for each Board meeting attended and a \$1,000 attendance fee for each committee meeting attended, except that the compensation for

telephone conference meetings is \$1,000 and \$500 for board and committee telephone conference meetings, respectively. A committee chairperson receives an additional \$5,000 retainer per year and the Audit Committee chairperson receives a \$15,000 annual retainer. The Company may, in its discretion, determine to pay all or a portion of any annual retainer in shares of Common Stock, in lieu of cash and to make discretionary grants of Common Stock to non employee Directors from time to time. The Company has not elected to pay the annual retainer in shares or make discretionary grants during the past three years.

*Directors Equity Awards.* Currently, each Director is eligible to participate in the 2005 Long Term Incentive Plan. During the 2012 fiscal year, 15,000 options were granted to one Director. As of May 20, 2013, stock awards covering 30,000 shares of Common Stock have been granted to Directors and are outstanding under the 2005 Long Term Incentive Plan. Previously, each outside Director was entitled to participate in the Company's 1990 Stock Option Plan for Non-Employee Directors (the "Directors Plan"), which expired in 2010. As of May 20, 2013, Director awards covering 67,546 shares of Common Stock have been granted and are outstanding under the Directors Plan.

An initial grant of 15,000 stock options is made to each new Director. In addition, on or about May 1 of each year, Directors are entitled to receive grants of deferred shares of Common Stock ("Deferred Shares") under the 2005 Long Term Incentive Plan representing \$80,000 in market value of Common Stock as of the date of grant. The Deferred Share grants vest on the date of grant. Prior to December 31, 2010, each Director elected to either receive cash in lieu of the deferred shares, Common Stock with respect to the Deferred Shares upon grant or to defer the receipt of such Common Stock until such person is no longer a Director, except that a cash election could be made only if the Board member held 4x the value of the annual retainer (\$50,000) in Common Stock, including Deferred Shares, based on the 120 day average closing price as of the prior December 1st. During the 2012 fiscal year, each non-executive Director received cash in lieu of Deferred Shares. The Board of Directors is authorized, in its discretion, to grant additional stock options or Common Stock awards to Directors Plan participants.

*Retirement Plan.* Prior to June 1, 2003, the Company provided the Board of Directors with a noncontributory, unfunded retirement plan that paid a retired Director an annual retirement benefit equal to 60% of the annual retainer at the time of retirement plus a 3% annual increase through the final payment. Payments began at age 62 or retirement, whichever was later, and continued for 10 years or the life of the Director and his or her spouse, whichever period is shorter. Partial vesting in the retirement plan began after six years of continuous service. Participants became fully vested after 12 years of continuous service on the Board.

As of June 1, 2003, new Directors were not covered by the retirement plan. Directors who were not yet vested in their retirement benefits at such time had the present value of benefits already accrued converted to Deferred Shares under the Directors Plan. Directors that were fully or partially vested in their retirement benefits on June 1, 2003 were given a one-time election to continue to participate in the retirement program or convert the present value of benefits already accrued to Deferred Shares under the Directors Plan as of June 1, 2003. As of the completion of the last fiscal year, only Mr. Kaufman participates in the retirement plan.

## COMPENSATION OVERVIEW

### Introduction

This overview describes the material elements of compensation for the Company's executive officers identified in the Summary Compensation Table below (who are referred to below as the "named executive officers"), the process by which such elements are determined and established by the Compensation Committee for the respective individuals and the principles and considerations underlying such determinations.

The compensation decisions for the named executive officers relating to 2011 took into account, among other things, the Company's consolidated financial results and the market price of the Company's stock. Discussions relating to the Company's consolidated financial results and operating

performance for the year are contained in the Management's Discussion and Analysis section of the Company's 2012 Annual Report on Form 10-K.

### **Compensation Objectives and Approach**

The objectives of our compensation programs are to attract, motivate, retain and reward executives and employees who will make substantial contributions toward the Company's meeting the financial, operational and strategic objectives that we believe will build substantial value for the Company's stockholders. In an effort to achieve these objectives, the key elements of such programs consist of base salary, annual performance-based cash bonuses and share-based compensation.

### **Compensation Determination Process and Considerations**

Mr. Higgins makes proposals to the Compensation Committee regarding the elements of compensation for each of the named executive officers, including his own compensation, and the Compensation Committee has full authority and discretion to accept, reject or modify these proposals. The Compensation Committee's compensation determinations regarding the named executive officers are reviewed by the full Board. Generally, these determinations are made annually and occur at the Compensation Committee's regular meeting of each fiscal year occurring in April, at which cash bonuses and share-based awards, if any, relating to the named executive officers' performance during the preceding fiscal year are granted, and any base salary adjustments for the current year are implemented. In preparation for these meetings, Mr. Higgins meets with the Compensation Committee Chairman to present his preliminary compensation proposals relating to the named executive officers to be addressed in the April meeting, based on the anticipated full-year financial results for the Company and its subsidiaries.

The Compensation Committee reviews and approves each element of compensation for the named executive officers. In establishing the levels and components of compensation for the named executive officers, the Compensation Committee, as a threshold matter, evaluates the overall performance for the year.

Key elements considered in the Compensation Committee's performance evaluations include corporate performance compared to the financial, operational and strategic goals for the applicable period, the officer's contributions to such performance and the officer's other accomplishments for the benefit of the Company during such period. In these evaluations, the Compensation Committee does not apply rigid formulas with respect to amount of compensation paid or the allocation between cash and non cash compensation, and it does not necessarily react to short-term changes in financial performance. Such evaluations also take into account the nature, scope and level of the named executive officer's responsibilities and the officer's level of experience, past levels of compensation and changes in such levels, tenure with the Company and other opportunities potentially available to such officer. In addition, the members of the Compensation Committee interact with each of the named executive officers in connection with the regular meetings of the Company's Board of Directors, which provides the committee with an additional basis for evaluating such officer and his performance. Based on all of these general evaluative factors and the additional factors described below that vary among the named executive officers, the Compensation Committee makes its assessments and determines the components and levels of compensation for each such officer.

The Company has sought to structure its overall compensation program to contain an appropriate mix of long-term and short-term incentives that balance risk and potential reward in a manner that is appropriate to the circumstances and in the best interest of the Company's stockholders. In particular, equity-based awards are structured to vest over a number of years, which encourages employees to focus on long-term results. Moreover, both annual incentive bonus and performance-based equity awards are subject to discretionary reduction if determined appropriate by the Compensation Committee. The Company believes that these factors reduce any incentive that employees may have to take inappropriate risks. Accordingly, the Company believes that its compensation policies and practices encourage and incentivize the employees to improve results in a disciplined, focused manner, with a view toward long-term success.

## Cash Compensation

The Company pays base salaries at levels it believes will attract and retain key employees and ensure that our compensation program is competitive. Base salaries for the named executive officers are established by the Compensation Committee, and reviewed by such Committee for potential adjustment on an annual basis, based on the considerations described in the preceding section. The base salary amounts paid to the named executive officers during the 2012 fiscal year are shown in the Summary Compensation Table at page 14.

The annual incentive bonus plan, the results of which are shown in the Summary Compensation Table in the Non-Equity Incentive Plan Compensation column, provides for a cash bonus, dependent upon the level of achievement of the stated corporate goals, calculated as a percentage of the officer's base salary, with higher ranked executive officers being compensated at a higher percentage of base salary. The Compensation Committee approves the target annual incentive award for the Chief Executive Officer and, for each officer below the Chief Executive Officer level, bases the target on the Chief Executive Officer's recommendations. For the 2012 fiscal year, the performance goal adopted for annual bonuses was based on achieving positive earnings before interest, taxes, depreciation and amortization ("EBITDA"). Upon achieving positive EBITDA, executive officers were entitled to their respective share of a \$3.6 million bonus pool. For EBITDA amounts above breakeven, the available pool was increased as a percentage of the incremental EBITDA above breakeven. For the 2012 fiscal year, the Company's earnings before interest, taxes, depreciation and amortization were \$16.2 million, which resulted in a total bonus pool of \$7.1 million. However, the Compensation Committee exercised negative discretion and reduced the bonus pool 19% to \$5.7 million.

## Share-Based Compensation

The Company believes that a component of its officers' compensation should consist of share-based incentive compensation, which appreciates or depreciates in value in relation to the market price of our common stock. Accordingly, the Compensation Committee has in recent years made, and intends in the future to continue to make, grants of share-based awards to the named executive officers and other key employees in such amounts as the Committee believes will accomplish the objectives of our compensation programs. As discussed below, the holder's ability to realize any financial benefit from these awards typically requires the fulfillment of substantial vesting requirements that are performance contingency-related in some cases and time-related in others. Accordingly, the Company believes that these awards provide substantial benefit to the Company in creating appropriate performance incentives and in facilitating the long-term retention of employees who add significant value.

## Retirement and Other Benefits

The Company's benefits program includes retirement plans and group insurance plans. The objective of the program is to provide select named executive officers with reasonable and competitive levels of protection against the four contingencies (retirement, death, disability and ill health) which could interrupt their employment and/or income received as an active employee. Retirement plans, including the supplemental executive retirement plan, are designed to provide a competitive level of retirement income to named executive officers and to reward them for continued service with the Company. The retirement program consists of a supplemental executive retirement plan and the 401(k) plan. Mr. Higgins and Mr. Eisenberg are participants in the supplemental executive retirement plan.

The group insurance program consists of life, disability and health insurance benefit plans that cover all full-time management and administrative employees and the supplemental long-term disability plan, which covers the named executive officers and other officers.

## Other Compensation

The Company continues to maintain modest executive benefits and perquisites for officers; however, the Compensation Committee in its discretion may revise, amend or add to the officers' executive benefits and perquisites if it deems it advisable. See The Summary Compensation Table for a summary of such benefits.

## Deductibility of Compensation Expenses

Section 162(m) of the Internal Revenue Code generally disallows a tax deduction to a public corporation for annual compensation over \$1 million for its named executive officers who are considered "covered employees" for purposes of Section 162(m). Qualifying performance based compensation will not be subject to the deduction limit if certain requirements are met. Executive compensation is structured to avoid limitations on deductibility where this result can be achieved consistent with the Company's compensation goals.

## Summary Compensation Table

The following table sets forth information regarding compensation earned by our Chief Executive Officer and our other most highly compensated Executive Officers:

Name	Principal Position	Year	Salary (\$) <sup>(1)</sup>	Stock Awards (\$) <sup>(2)</sup>	Option Awards (\$)	Non-Equity	All Other	Total
						Incentive Plan Compensation (\$) <sup>(3)</sup>	Compensation (\$) <sup>(5)</sup>	Compensation (\$)
Robert J. Higgins	Chairman of the Board and Chief Executive Officer	2012	800,000	—	—	2,750,000	183,304	3,733,304
		2011	900,000	456,234	—	1,125,000	181,332	2,662,566
Michael J. Honeyman <sup>(4)</sup>	Former President and Chief Operating Officer	2012	600,000	—	—	1,200,000	56,058	1,856,058
		2011	483,750	—	—	495,000	60,865	1,039,615
Bruce J. Eisenberg	Executive Vice President – Real Estate and Stores	2012	400,000	—	—	1,000,000	—	1,400,000
		2011	360,000	—	—	435,000	—	795,000

(1) Salary represents amounts earned during fiscal year.

(2) Amounts represent the grant date fair value, as computed in accordance with Accounting Standards Codification Topic 718, relating to share units awarded to Mr. Higgins during fiscal 2011. Effective April 12, 2011, Mr. Higgins was granted 279,898 performance based restricted stock units. The restricted stock units fully vested based on the achievement of performance targets and he received a cash payment of \$635,368.

(3) For the fiscal year 2012, amounts represent cash incentive payouts made to certain named executive officers for the achievement of the Company's Earnings Before Interest, Taxes, Depreciation and Amortization Target. In addition, for Mr. Eisenberg amounts represent a deferred cash grant made in fiscal 2008 and paid fiscal 2011 of \$75,000.

(4) Effective February 12, 2013, Mr. Honeyman and the Company mutually agreed to separate.

(5) Includes the following payments made by the Company to the named executive officers:

Name	Year	Perquisites and Other Personnel Benefits (\$)	Insurance Premiums (\$)	Total (\$)
Robert J. Higgins <sup>(1)</sup> .....	2012	33,304	150,000	183,304
	2011	31,332	150,000	181,332
Michael J. Honeyman <sup>(2)</sup> .....	2012	56,058	—	56,058
	2011	60,865	—	60,865
Bruce J. Eisenberg .....	2012	—	—	—

(1) Perquisites for Mr. Higgins during the 2012 fiscal year include club dues (\$6,733) and fees paid for a personal assistant (\$26,571). The cost of perquisites was determined on the basis of aggregate incremental cost to the Company.

(2) Perquisites for Mr. Honeyman during the 2012 fiscal year include housing expenses (\$28,536), auto expense (\$18,518) and reimbursement for Mr. Honeyman's personal health insurance policy (\$9,004).

## **Employment Agreement**

On December 26, 2008, the Company entered into an employment agreement with Mr. Higgins pursuant to which Mr. Higgins continued to serve as Chief Executive Officer of the Company. The original term of the agreement expired on December 31, 2012. The term is subject to automatic one year extensions starting on the second anniversary of the effective date unless prior written notice is given by the Mr. Higgins or the Company. Due to the automatic one year extensions, the current term of agreement expires on December 31, 2014, unless earlier terminated in accordance with its terms.

Under the agreement, Mr. Higgins will receive an annual base salary of \$1,000,000 (or such larger amount as the Company's Board of Directors may determine from time to time). For the fiscal year 2012, Mr. Higgins agreed to reduce his salary to \$800,000. Under the agreement, Mr. Higgins will be eligible for bonuses under the Company's executive bonus plan, under which Mr. Higgins will have an annual bonus opportunity based on the achievement of certain performance criteria as approved by the Board of Directors. Under the agreement, the Board of Directors may also determine to pay Mr. Higgins compensation in excess of the required base salary and bonus. He is entitled to participate in all incentive, savings, retirement, welfare and such other employee benefit programs as are generally in effect for the Company's executive employees and is also entitled to reimbursement for or payment of certain travel and other expenses. The agreement provided for the award of performance based restricted stock units during fiscal 2009, fiscal 2010 and fiscal 2011 which had an aggregate fair market value on the date of grant equal to \$1,100,000. This obligation was satisfied by grants of 279,898 units issued in fiscal 2009 and fiscal 2010 (which were forfeited because applicable performance goals were not met) and 279,898 units issued in 2011. Based on 2011 results, the Company achieved the targeted loss before interest, taxes, depreciation and amortization. Therefore, all the share units vested and Mr. Higgins was awarded cash payout of \$635,368.

Mr. Higgins has agreed to certain confidentiality, non-competition and non-solicitation provisions. In addition, he shall be entitled to gross-up payments in the event excise taxes on payments or benefits made to him are imposed under Section 4999 of the Internal Revenue Code or any similar state or local tax law. The agreement also provides for indemnification during the contract period and for a period of five years thereafter.

## Outstanding Equity Awards at Fiscal Year-End

The table below summarizes the named executive officers' equity awards that were unvested or unexercised, as applicable, as of February 2, 2013.

Name	Grant Date	Option Awards			
		Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Option Exercise Price (\$)	Option Expiration Date
Robert J. Higgins.....	5/1/2003	1,000,000	—	3.50	5/1/2013
	4/30/2004	550,000	—	10.31	4/30/2014
	5/2/2005	475,000	—	14.32	5/2/2015
	5/1/2006	450,000	—	5.32	5/1/2016
Michael J. Honeyman .....	5/6/2010 <sup>(1)</sup>	150,000	550,000	2.11	5/6/2020
Bruce J. Eisenberg .....	5/1/2003	150,000	—	3.50	5/1/2013
	4/30/2004	60,000	—	10.31	4/30/2014
	5/2/2005	50,000	—	14.32	5/2/2015
	5/1/2006	50,000	—	5.32	5/1/2016
	5/1/2007	50,000	—	5.50	5/1/2017
	5/6/2010 <sup>(2)</sup>	25,000	175,000	2.11	5/6/2020

- (1) Mr. Honeyman's options vest based on service period with 75,000 vesting after each of the first two years of service and 275,000 vesting after the third and fourth years of service. Effective February 12, 2013, Mr. Honeyman and the Company mutually agreed to separate. Upon separation, the 550,000 unvested options were forfeited.
- (2) Mr. Eisenberg's options vest based on service period with 25,000 vesting after each of the first three years of service and 125,000 vesting after the fourth year of service.

## Pension Benefits

The Company maintains a non-qualified Supplemental Executive Retirement Plan ("SERP") for certain executive officers of the Company. The SERP, which is a non-qualified plan, provides eligible executives defined pension benefits that supplement benefits under other retirement arrangements. The annual benefit amount is equal to 50% of the average of the participant's base compensation for the five years prior to retirement plus the average of the three largest bonus payments for the last five years prior to retirement, to the extent vested. Participants vest 35% after 10 years, 75% after 20 years and 100% after 20 years of service and retirement at the age of 65. In addition, the benefits become vested in full upon a change in control of the Company prior to the participant's termination of employment or a termination of employment due to the participant's death or disability. Additionally, all benefits under the SERP will be forfeited in the event of any of the following: competitive conduct during the 5 years following termination of employment or at any time while in receipt of benefits; solicitation for employment or employment of company employees during the 5 years following termination or at any time while in receipt of benefits (this clause is waived in the event of a change in control); disclosure of confidential information; or termination for cause. During the 2012 fiscal year, the Compensation Committee of the Board of Directors approved setting Mr. Higgins' annual benefit to \$950,000 annually.

Payments are made in equal installments over 20 years. The Company has established a rabbi trust whose purpose is to be a source of funds to pay benefits to participants in the SERP.

## Severance Benefits

Other than the employment agreement entered into between the Company and Mr. Higgins, the Company has not entered into any agreements with the named executive officers which provide severance or other benefits upon a termination of employment or a change in control.

Mr. Higgins' employment agreement provides that, in the event of his termination by reason of death or disability (as defined in the agreement), the executive (or in the case of death, the executive's spouse or estate) shall be entitled to receive: (i) earned but unpaid base salary; (ii) reimbursement for expenses incurred prior to termination; (iii) payment for accrued but unused



vacation; and (iv) the annual bonus for the fiscal year of termination in an amount determined by the Compensation Committee based on the achievement of performance goals for the fiscal year but pro-rated to reflect the number of days in the fiscal year through the date of termination. Following a termination by reason of disability, he will also receive an amount equal to two times his base salary for the period from the date of termination through the six month anniversary of the date of termination.

In the event of his termination by the Company for cause (as defined in the agreement) or by the executive for any reason other than good reason (as defined in the agreement), the Company's remaining obligations under the agreement shall terminate.

In the event of his termination by the Company for any reason other than cause, death or disability or by the executive for good reason, Mr. Higgins shall be entitled to receive: (i) earned but unpaid base salary and accrued but unused vacation; (ii) reimbursement for expenses incurred prior to termination; and (iii) an amount equal to two times his base salary for the period from the date of termination until the latest of (A) the third anniversary of the effective date of the agreement, (B) the end of the contract period or (C) one year after the date of termination, payable over such period in accordance with the regular payroll practices of the Company. In addition, the Mr. Higgins (and his dependents) will be entitled to continue participation in the Company's medical, dental and vision care plans until the latest of (x) the third anniversary of the effective date; (y) the end of the contract period or (z) one year after the date of termination, provided, however, that such participation shall cease on any earlier date that Mr. Higgins becomes eligible for substantially similar benefits from a subsequent employer.

The Company has severance guidelines that are applicable to officers, including the named executive officers, who are not party to an employment agreement. Under those guidelines, which are subject to review and amendment by the Committee from time to time, an officer whose employment is terminated by the Company as a result of a reduction in force, position elimination or a failure to keep pace with the strategic demands of his or her position and who executes a release in the form requested by the Company is generally entitled to continue to receive one week of salary continuation, and continued participation in other benefit plans, for each year of service, with a minimum of 13 weeks and a maximum of 26 weeks for Vice President level officers.

In addition, unvested equity awards vest upon death, disability or a change of control pursuant to the terms of the 2005 Long Term Incentive Plan and applicable award agreements.

#### **RELATED PARTY TRANSACTIONS**

The Company leases its 181,300 square foot distribution center/office facility in Albany, New York from Robert J. Higgins, its Chairman, Chief Executive Officer and largest shareholder, under three capital leases that expire in the year 2015. The original distribution center/office facility was occupied in 1985.

Under the three capital leases, dated April 1, 1985, November 1, 1989 and September 1, 1998, the Company paid Mr. Higgins an annual rent of \$2.3 million in the 2012 fiscal year. Pursuant to the terms of the lease agreements, effective January 1, 2002 and every two years thereafter, rental payments will increase in accordance with the biennial increase in the Consumer Price Index. Under the terms of the lease agreements, the Company is responsible for property taxes, insurance and other operating costs with respect to the premises. Mr. Higgins doesn't have any future obligation for principal and interest. None of the leases contain any real property purchase options at the expiration of its term.

The Company leases one of its retail stores from Mr. Higgins under an operating lease. Annual rental payments under this lease were \$40,000 in the 2012 fiscal year. Under the terms of the lease, the Company pays property taxes, maintenance and a contingent rental if a specified sales level is achieved. Total additional charges for the store, including contingent rent, were approximately \$6,400 in the 2012 fiscal year.

Mark Higgins, the son of Robert J. Higgins was employed with the Company as Vice President—Merchandising Video, Video Games, Electronics and Accessories. During the 2012 fiscal year, Mark Higgins received \$339,000 in cash compensation.

The Board has assigned responsibility for reviewing related party transactions to its Audit Committee. The Audit Committee has adopted a written policy pursuant to which all transactions

between the Company or its subsidiaries and any Director or officer must be submitted to the Audit Committee for consideration prior to the consummation of the transaction. The transaction will then be evaluated by the Audit Committee to determine if the transaction is in our best interests and whether, in the Committee's judgment, the terms of such transaction are at least as beneficial to us as the terms we could obtain in a similar transaction with an independent third party. In order to meet these standards, the Committee may conduct a competitive bidding process, secure independent consulting advice, engage in its own fact-finding, or pursue such other investigation and fact-finding initiatives as may be necessary and appropriate in the Committee's judgment. The Audit Committee reports to the Board, for its review, on all related party transactions considered. The transactions that were entered into with an "interested Director" were approved by a majority of disinterested Directors of the Board of Directors, either by the Audit Committee or at a meeting of the Board of Directors.

#### **SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE**

Section 16(a) of the Securities Exchange Act of 1934 generally requires the Company's Directors, Executive Officers and persons who own more than ten percent of the registered class of the Company's equity securities to file reports of beneficial ownership and changes in beneficial ownership with the Securities and Exchange Commission. Based solely upon its review of the copies of such reports received by it, or upon written representations obtained from certain reporting persons, the Company believes that all Section 16(a) filing requirements applicable to its officers, Directors, and greater than ten percent stockholders were complied with.

#### **REPORT OF THE AUDIT COMMITTEE**

The Audit Committee reviews the Company's financial reporting process on behalf of the Board of Directors and monitors the Company's efforts to comply with certain aspects of the Sarbanes-Oxley Act of 2002. The Audit Committee of the Board has reviewed and discussed the Company's audited financial statements with the Company's Management and its independent accountants, KPMG LLP. Management is responsible for the financial statements and the underlying financial reporting processes, including the system of internal controls. The Audit Committee has discussed with KPMG LLP, the Company's independent accountants, the matters required to be discussed under professional standards. The Audit Committee also has received the written disclosures and the letter from the independent accountants required by Independence Standards Board Standard No. 1 (Independence Standards Board Standard No. 1, Independence Discussions with Audit Committees) and has discussed with KPMG LLP the independence of such independent accounting firm. The Committee has also considered whether the independent accountants' provision of information technology and other non-audit services to the Company is compatible with the accountants' independence.

The Audit Committee also discussed with the Company's internal auditors and with KPMG LLP the overall scope and plans for their respective audits. The Audit Committee meets periodically with the Company's internal auditors and with KPMG LLP, with and without management present, to discuss the results of their examinations, the evaluation of the Company's internal controls and the overall quality and transparency of the Company's financial reporting. Based on its review and discussions referred to above, the Audit Committee recommended to the Board that the audited financial statements for the fiscal year ended February 2, 2013 be included in the Company's Annual Report on Form 10-K for the Company's fiscal year ended February 2, 2013.

#### **Audit Committee of the Board of Directors**

**Isaac Kaufman (Chairman)**

**Dr. Joseph Morone**

**Robert Marks**

**Michael Nahl**

## OTHER MATTERS

*Other Items.* Management knows of no other items or matters that are expected to be presented for consideration at the meeting. However, if other matters properly come before April 24, 2013, the persons named in the accompanying proxy intend to vote thereon in their discretion.

*Proxy Solicitation.* The Company will bear the cost of the meeting and the cost of soliciting proxies, including the cost of mailing the proxy materials. In addition to solicitation by mail, Directors, officers, and regular employees of the Company (none of whom will be specifically compensated for such services) may solicit proxies by telephone or otherwise. Arrangements will be made with brokerage houses and other custodians, nominees, and fiduciaries to forward proxies and proxy materials to their principals, and the Company will reimburse them for their ordinary and necessary expenses.

*Independent Accountants.* The Board of Directors currently intends to select KPMG LLP as independent accountants for the Company for the fiscal year ending February 1, 2014. KPMG LLP has acted as accountants for the Company since 1994, when it purchased the Albany practice of Ernst & Young, the Company's accountants since 1985. Representatives of KPMG LLP will be present at the Annual Meeting and available to make statements to and respond to appropriate questions of shareholders.

The appointment of independent accountants is approved annually by the Board of Directors. The decision of the Board is based on the recommendation of the Audit Committee, which reviews and approves in advance the audit scope, the types of non-audit services, and the estimated fees for the coming year. The Audit Committee also reviews and approves non-audit services to ensure that they will not impair the independence of the accountants.

Before making its recommendation to the Board for appointment of KPMG LLP, the Audit Committee carefully considered that firm's qualifications as independent accountants for the Company. This included a review of its performance in prior years, as well as its reputation for integrity and competence in the fields of accounting and auditing. The Audit Committee's review included inquiry concerning any litigation involving KPMG LLP and any proceedings by the Securities and Exchange Commission against the firm. The following is a description of the fees billed to the Company by KPMG LLP for fiscal years 2012 and 2011.

*Audit Fees.* Audit fees include fees paid by the Company to KPMG LLP in connection with the annual audit of the Company's consolidated financial statements and KPMG LLP's review of the Company's interim financial statements. Audit fees also include fees for services performed by KPMG LLP that are closely related to the audit and in many cases could only be provided by independent accountants. Such services include comfort letters and consents related to SEC registration statements and certain reports relating to the Company's regulatory filings. The aggregate fees billed to the Company by KPMG LLP for audit services rendered to the Company and its subsidiaries for fiscal years 2012 and 2011 totaled \$331,600 and \$350,000, respectively.

*Audit Related Fees.* Audit related services include due diligence and audit services related to employee benefit plan audits and certain attest services. The aggregate fees billed to the Company by KPMG LLP for audit related services rendered to the Company and its subsidiaries for fiscal years 2012 and 2011 totaled \$19,500 for each year.

*Tax fees.* Tax fees include corporate tax compliance and counsel and advisory services. BST Advisors, LLC was the Company's primary tax advisor in fiscal year 2012. KPMG didn't receive any fees for tax services in the last two years.

Each year, the Company reviews its existing practices regarding the use of its independent accountants to provide non-audit and consulting services, to ensure compliance with recent SEC proposals. The Company has a policy which provides that the Company's independent accountants may provide certain non-audit services which do not impair the accountants' independence. In that regard, the Audit Committee must pre-approve all audit services provided to the Company, as well as non-audit services provided by the Company's independent accountants. This policy is administered by the Company's senior financial management, which reports throughout the year to the Audit Committee.

*Financial Statements.* The Company's 2012 Annual Report to Shareholders (which does not form a part of the proxy solicitation material), including financial statements for the fiscal year ended February 2, 2013, is being sent concurrently to shareholders. If you have not received or had access to the 2012 Annual Report to Shareholders, you may request a copy by writing to: Trans World Entertainment Corporation, Attention: Treasurer, 38 Corporate Circle, Albany, NY 12203, and a copy will be sent to you free of charge.

#### **SUBMISSION OF SHAREHOLDER PROPOSALS**

Shareholders of the Company wishing to include proposals in the proxy material relating to the Annual Meeting of the Company to be held in 2014 must submit the same in writing so as to be received at the executive offices of the Company on or before January 30, 2014. Such proposals must also meet the other requirements of the rules of the Securities and Exchange Commission relating to shareholders' proposals. Proposals should be addressed to Edwin J. Sapienza, Secretary, Trans World Entertainment Corporation, 38 Corporate Circle, Albany, NY 12203. No such proposals were received with respect to the Annual Meeting scheduled for July 2, 2013.

By Order of the Board of Directors,



Edwin J. Sapienza,  
Secretary

May 31, 2013

**TRANS WORLD ENTERTAINMENT CORPORATION  
CHARTER OF THE COMPENSATION COMMITTEE  
OF THE BOARD OF DIRECTORS**

**A. FORMATION OF THE COMPENSATION COMMITTEE**

There shall be a committee of the Board of Directors (the “Board”) of Trans World Entertainment Corporation, a New York corporation (the “Company”) to be known as the “Compensation Committee” (the “Committee”). The Committee shall be composed of directors who are independent of the management of the Company and are free of any relationship that, in the opinion of the Board, would interfere with the exercise of independent judgment as a committee member. Without limiting the generality of the preceding sentence, the directors appointed to the Committee shall satisfy (i) the independence criteria of the NASDAQ Stock Market and (ii) the applicable rules and regulations of the U.S. Securities and Exchange Commission (the “SEC”), and shall not be an “affiliated person” of the issuer or any subsidiary as defined under the Sarbanes-Oxley Act of 2002. In determining whether a director is eligible to serve on the Committee, the Board shall also consider whether the director is affiliated with the Company, a subsidiary of the Company or an affiliate of a subsidiary of the Company to determine whether such affiliation would impair the director’s judgment as a member of the Committee. In addition, if deemed appropriate from time to time, each director appointed to the Committee shall meet the definition of “non-employee director” under Rule 16b-3 under the Securities Exchange Act of 1934, and “outside director” for purposes of Section 162(m) of the Internal Revenue Code of 1986. Committee members shall not accept directly or indirectly any consulting, advisory or other compensatory fee from the Company or any subsidiary thereof. The Committee shall consist of no fewer than three independent directors, for a term of appointment at the discretion of the Board, considering the recommendation of the Nominating & Governance Committee, and further considering the views of the Chairman of the Board and the Chief Executive Officer (the “CEO”), as appropriate, usually for one year. The members of the Committee shall serve until their successors are appointed and qualify, and shall designate the Chairman of the Committee. The Board shall have the power at any time to change the membership of the Committee and to fill vacancies in it, subject to such new member(s) satisfying the above requirements and any other corporate legislation in effect at that time. Except as expressly provided in this Charter or the by-laws of the Company, the Committee shall fix its own rules of procedure.

**B. RESPONSIBILITIES OF THE COMMITTEE**

The Committee shall:

- (a) discharge the Board’s responsibilities relating to compensation of the Company’s executives (including the CEO and all other executive officers, as defined under Section 16 of the Securities Exchange Act of 1934, and related rules) and
- (b) prepare an annual report on executive compensation for inclusion in the Company’s proxy statement in accordance with applicable rules and regulations.

**C. DUTIES OF THE COMMITTEE**

In carrying out its responsibilities, the Committee shall:

**Review and approve all executive compensation.** The Committee shall review and approve corporate goals and objectives relevant to all executive officer compensation, evaluate each executive officer’s performance in light of those goals and objectives, and set the executive compensation level based on this evaluation. In determining the long-term incentive component of executive officers compensation, the Committee should consider the Company’s performance and relative shareholder return, the value of similar incentive awards to executive officers at comparable companies, and the awards given to the Company’s executive officers in past years.

The Company's CEO may not be present during any deliberations or voting regarding his or her compensation.

**Conduct an Annual Review.** The Committee shall annually review and make recommendations to the Board with respect to the compensation of all officers and other key executives.

**Make Recommendations to the Board.** The Committee shall make recommendations to the Board with respect to incentive compensation plans and equity-based plans.

**Have sole authority to retain and oversee external advisors.** The Committee shall have the sole authority to appoint, retain, oversee and terminate any internal or outside legal counsel, external auditor, accountants, financial consultant and other advisors (each a "compensation advisor") as it determines necessary or appropriate to assist in the execution of its duties and responsibilities set forth in this charter, including the evaluation of director, Chief Executive Officer and senior executive compensation. The Committee shall have sole authority to approve the compensation advisor's compensation, fees and other retention terms. The Company shall provide appropriate funding, as determined by the Committee, for the payment of reasonable compensation to compensation advisers retained by the Committee.

**Have sole authority in the selection of external advisors.** The Committee may select, or receive advice from, any compensation adviser it prefers, including ones that are not independent. However, the Committee may select, or receive advice from, a compensation adviser other than in-house legal counsel, only after taking into consideration the following six independence factors:

- (i) The provision of other services to the Company by the person that employs the compensation consultant, legal counsel or other adviser;
- (ii) The amount of fees received from the Company by the person that employs the compensation consultant, legal counsel or other adviser, as a percentage of the total revenue of the person that employs the compensation consultant, legal counsel or other adviser;
- (iii) The policies and procedures of the person that employs the compensation consultant, legal counsel or other adviser that are designed to prevent conflicts of interest;
- (iv) Any business or personal relationship of the compensation consultant, legal counsel or other adviser with a member of the Committee;
- (v) Any stock of the Company owned by the compensation consultant, legal counsel or other adviser; and
- (vi) Any business or personal relationship of the compensation consultant, legal counsel, other adviser or the person employing the adviser with an executive officer of the Company.

Notwithstanding the foregoing, the Committee is not required to conduct an independence assessment for a compensation adviser that acts in a role limited to the following activities for which no disclosure is required under the requirements of the SEC: (a) consulting on any broad-based plan that does not discriminate in scope, terms, or operation, in favor of executive officers or directors of the Company, and that is available generally to all salaried employees; and/or (b) providing information that either is not customized for a particular issuer or that is customized based on parameters that are not developed by the adviser, and about which the adviser does not provide advice.

For the avoidance of doubt, the Committee is not required to implement or act consistently with the advice or recommendations of any compensation adviser to the Committee. The retention of any outside advisers shall not affect the ability or obligation of the Committee to exercise its own judgment in fulfillment of its duties.

**Administer awards and incentives.** The Committee shall adopt, administer, approve and ratify awards under incentive compensation and stock plans, including amendments to the awards made under any such plans, and review and monitor awards under such plans.

**Make periodic reports.** The Committee shall make periodic reports to the Board.

**Review the Charter.** The Committee shall review and reassess the adequacy of this Charter annually and recommend any proposed changes to the Board for approval.

**Review Committee performance.** The Committee shall annually review its own performance.

**Delegation of authority.** The Committee may form and delegate authority to subcommittees when appropriate.

**Review overall compensation for officer employees.** The Committee shall review the overall compensation structure of the Company to determine that it establishes appropriate incentives for officer employees at all levels. All incentives, while industry-dependent and different for different categories of officers should further the Company's long-term strategic plan and be consistent with the culture of the Company and the overall goal of enhancing shareholder value.

April 2013

**TRANS WORLD ENTERTAINMENT CORPORATION  
CHARTER OF THE NOMINATING AND CORPORATE GOVERNANCE  
COMMITTEE OF THE BOARD OF DIRECTORS**

**A. FORMATION OF THE NOMINATING AND CORPORATE GOVERNANCE COMMITTEE**

There shall be a committee of the Board of Directors (the “Board”) of Trans World Entertainment Corporation, a New York corporation (the “Company”), to be known as the “Nominating and Corporate Governance Committee” (the “Committee”). The Committee shall be composed of directors who are independent of the management of the Company and are free of any relationship that, in the opinion of the Board, would interfere with the exercise of independent judgment as a Committee member. Without limiting the generality of the preceding sentence, the directors appointed to the Committee shall satisfy the independence requirements of the NASDAQ National Market and shall not be an affiliated person of the issuer or any subsidiary as defined under the Sarbanes-Oxley Act of 2002. The Committee shall consist of no fewer than three independent directors, for a term of appointment at the discretion of the Board of Directors, considering the views of the Chairman of the Board and the Chief Executive Officer, as appropriate, usually for one year. The members of the Committee shall serve until their successors are appointed and qualify, and shall designate the Chairman of the Committee. The Board shall have the power at any time to change the membership of the Committee and to fill vacancies in it, subject to such new member(s) satisfying the above requirements and any other corporate legislation in effect at that time. The Committee may form and delegate authority to subcommittees when appropriate, and shall meet as necessary, but at least once each year, in order to enable it to fulfill its responsibilities and duties as set forth herein. Except as expressly provided in this Charter, the by-laws of the Company and any applicable corporate governance guidelines of the Company, the Committee shall fix its own rules of procedure.

**B. RESPONSIBILITIES OF THE COMMITTEE**

The Committee shall (1) assist the Board in identifying individuals qualified to become Board members and recommend to the Board the director nominees for the next annual meeting of shareholders; (2) recommend members of the Board to serve on the committees of the Board; (3) recommend to the Board individuals qualified to be elected as officers of the Company; (4) recommend to the Board the corporate governance and business ethics policies, principles, guidelines and codes of conduct applicable to the Company; and (5) lead the Board in its annual review of the Board’s performance.

**C. DUTIES OF THE COMMITTEE**

NOMINATING. The Committee shall:

- Develop policies on the size and composition of the Board and qualification criteria, as prescribed by corporate legislation and NASDAQ rules, for Board members in order to insure that the Board is comprised of members reflecting the proper expertise, skills, attributes and personal and professional backgrounds for service as a director of the Company and who have sufficient time available to devote to the affairs of the Company;
- Actively seek, interview and screen individuals qualified to become Board members for recommendation to the Board;
- Receive suggestions concerning possible candidates for election to the Board, including self-nominations, nominations from shareholders in accordance with the Company’s by-laws and other third-party nominations;



- Recommend to the Board individuals for vacancies occurring from time to time on the Board, including vacancies resulting from an increase in the size of the Board;
- Recommend the slate of nominees to be proposed for election at each annual meeting of shareholders;
- Recommend members of the Board to serve on the committees of the Board; and
- Recommend to the Board individuals qualified to be elected as officers of the Company.

**CORPORATE GOVERNANCE. The Committee shall:**

- Develop and recommend to the Board a set of corporate governance and business ethics policies, principles, guidelines and codes of conduct applicable to the Company and its directors, officers and employees;
- Review and reassess at least annually the adequacy of the Company's corporate governance and business ethics policies, principles, guidelines and codes of conduct in light of emerging issues and developments related to corporate governance and other factors and formulate and recommend any proposed changes to the Board for approval;
- Generally advise the Board as a whole on corporate governance matters;
- Review and reassess at least annually the adequacy of this Charter and recommend any proposed changes to the Board for approval;
- Annually review its own performance; and
- Review and assess the management succession plan for the Chief Executive Officer position.

**OTHER. The Committee shall have the authority to:**

- Request reports from internal or external sources on matters related to its authority and duties as described in this Charter and on any subject that it deems related to its responsibilities;
- Retain and terminate any search firm to be used to identify director or officer candidates and to approve the search firm's fees and other retention terms;
- Receive communications from shareholders and provide copies or summaries of such communications to the other Directors, as the Chairman of the Committee considers appropriate;
- Retain and terminate outside accountants, legal counsel and other advisors to advise the Committee with respect to Committee matters as it may deem appropriate in its sole discretion and approve related fees and retention terms; and
- Perform such other activities as the Committee or the Board may from time to time deem necessary or appropriate.

**D. PROCEDURE FOR SHAREHOLDER NOMINATIONS**

(A) The Committee will consider nominations submitted by shareholders. To recommend a nominee, a shareholder must write to the Company's Secretary. To be considered by the Committee for nomination and inclusion in the Company's proxy statement for its annual meeting of shareholders, a shareholder recommendation for a director must be received by the Company's Secretary no later than the deadline for submitting shareholder proposals pursuant to Rule 14a-8(e) of the Securities Exchange Act of 1934. Any recommendation must include (i) the name and address of the candidate, (ii) a brief biographical description, including his or her occupation for at least the last five years, and a statement of the qualifications of the candidate, taking into account the qualification requirements summarized above, and (iii) the candidate's signed consent to be named in the proxy statement and to serve as a director if elected. The

Committee may seek additional biographical and background information from any candidate that must be received on a timely basis to be considered by the Committee.

**(B)** Assuming the appropriate biographical and background material is provided for candidates submitted by shareholders, the Committee will evaluate those candidates by applying substantially the same criteria, as for candidates submitted by Board members.

April 2013

**T r a n s   W o r l d   E n t e r t a i n m e n t**

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[www.twec.com](http://www.twec.com)**