HANDLEMAN CO /MI/
Form 10-Q
March 15, 2001

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the third quarter ended January 31, 2001   Commission File Number 1-7923

Handleman Company

(Exact name of registrant as specified in its charter)

MICHIGAN	38-1242806
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

500 KIRTS BOULEVARD TROY, MICHIGAN	48084-4142	Area Code 248 362-4400
(Address of principal executive offices)	(Zip code)	(Registrant's telephone number)

Indicate by checkmark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for at least the past 90 days.

YES   X   NO ______

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

CLASS	DATE	SHARES OUTSTANDING
Common Stock - $.01 Par Value	March 2, 2001	26,932,117

HANDLEMAN COMPANY

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HANDLEMAN COMPANY
CONSOLIDATED STATEMENT OF INCOME
(UNAUDITED)
(amounts in thousands except per share data)

	Three Months (13 Weeks) Ended		Nine Months (39 Weeks)	
	January 31, 2001	January 31, 2000	January 31, 2001	January 2000
Revenues	$348,974	$343,246	$878,002	$858
Costs and expenses:				
Direct product costs	266,836	262,652	658,456	644
Selling, general and administrative expenses	58,518	54,375	167,731	160
Interest expense, net	336	1,088	1,939	2
Income before income taxes and minority interest	23,284	25,131	49,876	50
Income tax expense	(6,646)	(10,175)	(16,991)	(20
Minority interest	(382)	(296)	(745)	(1
Net income	$ 16,256	$ 14,660	$ 32,140	$ 28

Net income per share:

Basic	$ 0.60	$ 0.50	$ 1.17	$
Diluted	$ 0.60	$ 0.50	$ 1.16	$
Weighted average number of shares outstanding during the period:				
Basic	27,149	29,034	27,493	29
Diluted	27,214	29,383	27,649	30

The accompanying notes are an integral part of the consolidated financial statements.

HANDLEMAN COMPANY
CONSOLIDATED BALANCE SHEET
(amounts in thousands except share data)

	January 31, 2001 (Unaudited)
ASSETS	
Current assets:	
Cash and cash equivalents	$ 18,980
Accounts receivable, less allowance of $13,245 at January 31, 2001 and $17,383 at April 29, 2000, respectively, for the gross profit impact of estimated future returns	226,780
Merchandise inventories	112,903
Other current assets	13,862
Total current assets	372,525
Property and equipment:	
Land	1,233
Buildings and improvements	17,038
Display fixtures	35,337
Equipment, furniture and other	58,306
	111,914
Less accumulated depreciation	58,834
Property and equipment, net	53,080
Other assets, net	97,323

Total assets	$522,928
LIABILITIES	
Current liabilities:	
Accounts payable	$161,973
Debt, current portion	14,571
Accrued and other liabilities	34,970
Total current liabilities	211,514
Debt, non-current	47,986
Other liabilities	15,219
SHAREHOLDERS' EQUITY	
Preferred stock, $1.00 par value; 1,000,000 shares authorized; none issued	--
Common stock, $.01 par value; 60,000,000 shares authorized; 26,987,000 and 27,691,000 shares issued at January 31, 2001 and April 29, 2000, respectively	270
Foreign currency translation adjustment	(7,154)
Unearned compensation	(147)
Retained earnings	255,240
Total shareholders' equity	248,209
Total liabilities and shareholders' equity	$522,928

The accompanying notes are an integral part of the consolidated financial statements.

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HANDLEMAN COMPANY
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
(UNAUDITED)
(amounts in thousands)

	Nine Months (39 Weeks) Ended January 31			
	Common Stock			
	Shares Issued	Amount	Foreign Currency Translation Adjustment	Unearned Compensatio
April 29, 2000	27,691	$277	($6,449)	($4
Net income				

Adjustment for foreign currency translation			(705)	
Comprehensive income, net of tax				
Common stock issuances, net of forfeitures, in connection with employee benefit plans	38			2
Common stock repurchased	(742)	(7)		
January 31, 2001	26,987	$270	($7,154)	($1

The accompanying notes are an integral part of the consolidated financial statements.

HANDLEMAN COMPANY
CONSOLIDATED STATEMENT OF CASH FLOWS
(UNAUDITED)
(amounts in thousands)

	Nine Months (
	January 31, 2001
Cash flows from operating activities:	
Net income	$ 32,140
Adjustments to reconcile net income to net cash provided from operating activities:	
Depreciation	11,939
Amortization of acquisition costs	3,269
Recoupment of license advances	9,197
(Increase) decrease in accounts receivable	7,225
Increase in merchandise inventories	(12,605)
(Increase) decrease in other operating assets	(405)
Increase (decrease) in accounts payable	(40,366)
Increase in other operating liabilities	4,685
Total adjustments	(17,061)

Net cash provided from operating activities	15,079
Cash flows from investing activities:	
Additions to property and equipment	(19,112)
Retirements of property and equipment	5,458
License advances and acquired rights	(16,742)
Cash investment in Lifetime Entertainment Limited	--
Net cash used by investing activities	(30,396)
Cash flows from financing activities:	
Issuances of debt	498,475
Repayments of debt	(484,475)
Repurchase of common stock	(7,024)
Other changes in shareholders' equity, net	(189)
Net cash provided from (used by) financing activities	6,787
Net decrease in cash and cash equivalents	(8,530)
Cash and cash equivalents at beginning of period	27,510
Cash and cash equivalents at end of period	$ 18,980

The accompanying notes are an integral part of the consolidated financial statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. In the opinion of Management, the accompanying consolidated balance sheet and consolidated statements of income, shareholders' equity and cash flows contain all adjustments, consisting only of normal recurring adjustments necessary to present fairly the financial position of the Company as of January 31, 2001, and the results of operations and changes in cash flows for the nine months then ended. Because of the seasonal nature of the Company's business, sales and earnings results for the nine months ended January 31, 2001 are not necessarily indicative of what the results will be for the full year. The consolidated balance sheet as of April 29, 2000 included in this Form 10-Q was derived from the audited consolidated financial statements of the Company included in the Company's 2000 Annual Report on Form 10-K filed with the Securities and Exchange Commission. Reference should be made to the Company's Form 10-K for the year ended April 29, 2000.

2. At each balance sheet date, Management evaluates the carrying value and remaining estimated lives of long-lived assets, including intangible assets, for potential impairment by considering several factors, including

Management's plans for future operations, recent operating results, market trends and other economic factors relating to the operation to which the assets apply. Recoverability of these assets is measured by a comparison of the carrying amount of such assets to the future undiscounted net cash flows expected to be generated by the assets. If such assets were deemed to be impaired as a result of this measurement, the impairment that would be recognized is measured by the amount by which the carrying amount of the assets exceed the fair value of the assets as determined on a discounted basis.

3. In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133 "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"). This Statement establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives), and for hedging activities. This statement will be adopted in fiscal 2002. The Company does not believe the impact of SFAS 133 on reported earnings and financial position will be material.

4. The Company operates in two business segments: Handleman Entertainment Resources (H.E.R.) is responsible for music category management and distribution operations, and North Coast Entertainment (NCE) is responsible for the Company's proprietary operations, which include music, video and licensing operations.

   The accounting policies of the segments are the same as those described in Note 1, "Accounting Policies," contained in the Company's Form 10-K for the year ended April 29, 2000. Segment data includes intersegment revenues, as well as a charge allocating corporate costs to the operating segments. The Company evaluates performance of its segments and allocates resources to them based on income before interest, income taxes and minority interest ("segment income").

Notes to Consolidated Financial Statements (continued)

The tables below present information about reported segments for the three months ended January 31, 2001 and January 31, 2000 (in thousands of dollars):

Three Months Ended January 31, 2001:	H.E.R.	NCE	Total
Revenues, external customers	$314,446	$ 34,528	$348,974
Intersegment revenues	--	4,306	4,306
Segment income	20,958	2,531	23,489
Capital expenditures	5,490	775	6,265

Three Months Ended January 31, 2000:	H.E.R.	NCE	Total
Revenues, external customers	$312,144	$ 31,102	$343,246
Intersegment revenues	--	4,306	4,306
Segment income	22,708	3,180	25,888
Capital expenditures	2,696	1,865	4,561

A reconciliation of total segment revenues to consolidated revenues and total segment income to total consolidated income before income taxes and minority interest for the three months ended January 31, 2001 and January 31, 2000 is as follows (in thousands of dollars):

	Jan. 31, 2001	Jan. 31, 2000
Revenues		
Total segment revenues	$353,280	$347,552
Elimination of intersegment revenues	(4,306)	(4,306)
Consolidated revenues	$348,974	$343,246
Income Before Income Taxes and Minority Interest		
Total segment income for reportable segments	$23,489	$25,888
Interest revenue	715	435
Interest expense	(1,051)	(1,523)
Unallocated corporate income (costs)	131	331
Consolidated income before income taxes and minority interest	$23,284	$25,131

Notes to Consolidated Financial Statements (continued)

The tables below present information about reported segments as of and for the nine months ended January 31, 2001 and January 31, 2000 (in thousands of dollars):

Nine Months Ended January 31, 2001:	H.E.R.	NCE	Total
Revenues, external customers	$777,309	$100,693	$878,002
Intersegment revenues	--	8,928	8,928
Segment income	44,804	6,458	51,262
Total assets	422,867	189,918	612,785
Capital expenditures	16,396	2,716	19,112

Nine Months Ended January 31, 2000:	H.E.R.	NCE	Total
Revenues, external customers	$757,760	$100,698	$858,458
Intersegment revenues	--	9,955	9,955
Segment income	39,975	12,723	52,698
Total assets	401,795	177,319	579,114
Capital expenditures	10,814	4,732	15,546

A reconciliation of total segment revenues to consolidated revenues, total segment income to total consolidated income before income taxes and minority interest, and total segment assets to total consolidated assets as of and for the nine months ended January 31, 2001 and January 31, 2000 is as follows (in thousands of dollars):

	Jan. 31, 2001	Jan. 31, 2000
Revenues		
Total segment revenues	$ 886,930	$ 868,413
Elimination of intersegment revenues	(8,928)	(9,955)
Consolidated revenues	$ 878,002	$ 858,458
Income Before Income Taxes and Minority Interest		
Total segment income for reportable segments	$ 51,262	$ 52,698
Interest revenue	1,520	1,565
Interest expense	(3,459)	(3,990)
Unallocated corporate income (costs)	553	31
Consolidated income before income taxes and minority interest	$ 49,876	$ 50,304

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Notes to Consolidated Financial Statements (continued)

	Jan. 31, 2001	Jan. 31, 2000
Assets		
Total segment assets	$ 612,785	$ 579,114
Elimination of intercompany receivables and payables	(89,857)	(61,864)
Total consolidated assets	$ 522,928	$ 517,250

5. A reconciliation of the weighted average shares used in the calculation of basic and diluted shares is as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	Jan. 31, 2001	Jan. 31, 2000	Jan. 31, 2001	Jan. 31, 2000
Weighted average shares during the period-basic	27,149	29,034	27,493	29,863
Additional shares from assumed exercise of stock options	65	349	156	323
Weighted average shares adjusted for				

assumed exercise of stock options-diluted	27,214	29,383	27,649	30,186
	======	======	======	======

Handleman Company
Management's Discussion and Analysis of
Financial Condition and Results of Operations

Revenues for the third quarter of fiscal 2001, which ended January 31, 2001, increased to $349.0 million, from $343.2 million for the third quarter of fiscal 2000, which ended January 31, 2000. Net income for the third quarter of fiscal 2001 was $16.3 million or $.60 per diluted share, compared to $14.7 million or $.50 per diluted share for the third quarter of fiscal 2000.

Revenues for the first nine months of fiscal 2001 were $878.0 million, compared to $858.5 million for the first nine months of fiscal 2000. Net income for the nine-month period this year was $32.1 million or $1.16 per diluted share, compared to $28.8 million or $.95 per diluted share for the comparable nine-month period last year.

The Company has two business segments: Handleman Entertainment Resources ("H.E.R.") and North Coast Entertainment ("NCE"). H.E.R. consists of music category management and distribution operations in the United States, Canada, United Kingdom, Mexico and Brazil. NCE encompasses the Company's proprietary operations, which include music, video and licensing operations.

H.E.R. net sales were $314.4 million for the third quarter of this year, compared to $312.1 million for the third quarter of last year. H.E.R. net sales for the nine months ended January 31, 2001 increased to $777.3 million from $757.8 million for the nine months ended January 31, 2000. This increase in net sales for the nine-month period this year versus last year was principally due to increased sales within the United Kingdom.

NCE net sales were $38.8 million for the third quarter of fiscal 2001, compared to $35.4 million for the third quarter of fiscal 2000. The increased sales volume in the third quarter of this year versus last year was driven by higher sales at the Anchor Bay Entertainment operating unit. Net sales at NCE for the first nine months of this year were $109.6 million, compared to $110.7 million for the first nine months of last year.

Consolidated direct product costs as a percentage of consolidated revenues was 76.5% for the third quarter of both this year and last year, and for the nine months ended January 31, 2001 was 75.0%, compared to 75.1% for the nine months ended January 31, 2000.

Consolidated selling, general and administrative ("SG&A") expenses were $58.5 million or 16.8% of consolidated revenues for the third quarter of fiscal 2001, compared to $54.4 million or 15.8% of consolidated revenues for the third quarter of fiscal 2000. SG&A expenses this year were impacted by $3.4 million of incremental costs incurred to implement the Company's Channel of Choice strategy in the United Kingdom and develop the Company's e-business initiatives. The Company expects costs associated with these activities to continue in the fourth quarter of this year; however, there will be revenues generated in the fourth quarter from these investments, particularly in the United Kingdom.

Consolidated SG&A expenses for the first nine months of this year were $167.7 million or 19.1% of consolidated revenues, compared to $160.8 million or 18.7% of consolidated revenues for the comparable nine-month period last year. This increase in SG&A expenses was primarily a result of the incremental costs associated with the implementation of the Company's Channel of Choice strategy and e-business initiatives, as mentioned above.

Income before interest, income taxes and minority interest ("operating income") for the third quarter of fiscal 2001 was $23.6 million, compared to $26.2 million for the third quarter of fiscal 2000. H.E.R. operating income was $21.0 million for the third quarter of this year, compared to $22.7 million for the third quarter of last year. Operating income at H.E.R. was impacted by the $3.4 million of incremental costs associated with the implementation of the Company's Channel of Choice strategy in the United Kingdom and the development of the Company's e-business initiatives. NCE operating income was $2.5 million for the third quarter of fiscal 2001, compared to $3.2 million for the third quarter of fiscal 2000. This decrease at NCE was due to lower operating results this year versus last year at the Madacy Entertainment and The itsy bitsy Entertainment Company operating units, while operating income at Anchor Bay Entertainment improved over last year.

Operating income for the first nine months of this year was $51.8 million, compared to $52.7 million for the first nine months of last year. H.E.R. operating income increased to $44.8 million for the first nine months of fiscal 2001 from $40.0 million for the comparable prior year period. This increase in H.E.R. operating income was mainly due to increased sales volume. NCE operating income was $6.5 million for the first nine months of this year, compared to $12.7 million for the first nine months of last year. This decrease in operating income at NCE was primarily due to lower operating results at the Madacy Entertainment and The itsy bitsy Entertainment Company operating units. The Company expects that NCE operating income for fiscal 2001 will be less than its operating income for fiscal 2000.

During the third quarter of this year, the Company recognized tax benefits resulting from tax planning initiatives. The effective income tax rate for the third quarter was 28.5%, compared to 40.5% for the same period last year. The Company expects the effective tax rate in the fourth quarter of this year to be in line with the fiscal 2001 nine-month rate of 34.1%.

Interest expense for the third quarter of fiscal 2001 was $.3 million, compared to $1.1 million for the third quarter of fiscal 2000. Interest expense for the nine months ended January 31, 2001 decreased to $1.9 million from $2.4 million for the nine months ended January 31, 2000. This decrease in interest expense for both the quarter and nine-month period was attributable to lower borrowing levels.

Accounts receivable decreased to $226.8 million at January 31, 2001 from $234.0 million at April 29, 2000. This decrease was mainly due to the Company's on-going collection efforts.

Merchandise inventories increased to $112.9 million at January 31, 2001 from $100.3 million at April 29, 2000. This increase was primarily due to the seasonality of product returns from customers.

Other assets, net at January 31, 2001 was $97.3 million, compared to $90.0 million at April 29, 2000. This increase was principally due to additional license investments within NCE.

Accounts payable at January 31, 2001 was $162.0 million, compared to $202.3

million at April 29, 2000. This decrease was primarily due to the timing of vendor payments relating to inventory purchases made during the holiday season.

Debt, non-current at January 31, 2001 was $48.0 million, compared to $34.0 million at April 29, 2000. This increase was mainly due to higher borrowing levels during the third quarter of fiscal 2001 versus the fourth quarter of fiscal 2000.

During the third quarter of this year, the Company repurchased 376,080 shares of its stock at an average price of $7.88 per share. Included in the shares purchased during the quarter were 115,000 shares repurchased as part of the 10% share repurchase program announced in December 2000. The Company has repurchased 741,580 shares of its stock during the nine-month period ending January 31, 2001 at an average price of $9.47 per share. Since September 1997, the Company has repurchased approximately 22% of its outstanding shares (prior to initiating the stock repurchase programs) at a cost of $79 million. As of January 31, 2001, the Company had 26,987,450 shares outstanding, compared to 28,469,324 shares outstanding as of January 31, 2000.

The Company continued its international expansion with the commencement of category management, distribution and service to a discount retailer in the United Kingdom beginning February 1, 2001. The Company anticipates, going forward, that Handleman UK Limited will generate an additional $100 million of sales on an annual basis. In addition, the Company has made progress in the implementation of its e-business initiatives linked to its category management services. The expansion of the Company's SKU selection to provide fulfillment for e-commerce is anticipated to be completed by the fourth quarter of fiscal 2001. When completed, the Company's U.S. SKU count will total approximately 60,000, and accommodate direct to consumer fulfillment in partnership with the Company's retail customers, or support in-store pickup of merchandise ordered electronically. The Company installed its first generation, internet-based music kiosks in a pilot group of customer retail stores during the third quarter of this year. These kiosks will serve as the "music expert," providing a wide range of information on each title, including track information, music sampling and product availability. Through the kiosks, consumers will be able to order additional titles not found on the store shelves. The Company will integrate its e-fulfillment options with its customers, allowing the consumer to have the product shipped to the consumer's home or to the retail store for pickup. During the fourth quarter of fiscal 2001, the Company anticipates the testing of manufacturing on demand through these kiosks. In addition, the Company has developed an application service provider ("ASP") service to support ordering music product through customer web sites.

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This document contains forward-looking statements that are not historical facts and involve risk and uncertainties. Actual results, events and performance could differ materially from those contemplated by these forward-looking statements, including, without limitations, conditions in the music industry, ability to enter into profitable agreements with customers in the new businesses outlined in the Company's strategic growth plan, securing funding or providing sufficient cash required to build and grow the new businesses, customer requirements, continuation of satisfactory relationships with existing customers and suppliers, nature and extent of new product releases, retail environment, effects of electronic commerce, relationships with the Company's lenders, pricing and competitive pressures, certain global and regional economic conditions, and other factors discussed in this Form 10-Q and those detailed from time to time in the Company's other filings with the Securities and

Exchange Commission. The Company undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date of this document. Additional information that could cause actual results to differ materially from any forward-looking statements may be contained in the Company's Annual Report on Form 10-K.

PART II - OTHER INFORMATION

Item 6. Exhibits or Reports on Form 8-K

No reports on Form 8-K were filed during the quarter.

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

HANDLEMAN COMPANY

DATE: March 15, 2001 BY: /s/ Stephen Strome

STEPHEN STROME
Chairman and
Chief Executive Officer

DATE: March 15, 2001 BY: /s/ Leonard A. Brams

LEONARD A. BRAMS
Senior Vice President, Finance
and Chief Financial Officer
(Principal Financial Officer)