

PRELIMINARY PROSPECTUS DATED JUNE 16, 1986

\$65,000,000

CRAZY EDDIE® INC.



% Convertible Subordinated Debentures Due 2011

Interest Payable on June 15 and December 15

The Debentures are convertible into Common Stock of the Company at any time prior to maturity, unless previously redeemed, at a conversion price of \$ per share, subject to adjustment in certain events. On June 13, 1986, the last reported sale price of the Common Stock as reported on the NASDAQ National Market System was \$34¾ per share.

The Debentures provide for annual sinking fund payments commencing June 15, 1997 calculated to retire 70% of the principal amount thereof prior to maturity. The Debentures are not redeemable prior to June 15, 1988 unless the reported closing price of the Common Stock shall have equaled or exceeded 140% of the effective conversion price per share for any 20 trading days within a period of 30 consecutive trading days within a specified period prior to notice of such redemption. The Debentures are unsecured and subordinated to Senior Indebtedness of the Company (as defined in the Indenture). See "Description of Debentures."

**THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE
SECURITIES AND EXCHANGE COMMISSION NOR HAS THE COMMISSION
PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS.
ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.**

	Price to Public(1)	Underwriting Discounts and Commissions(2)	Proceeds to Company(1)(3)
Per Debenture	%	%	%
Total (4)	\$	\$	\$

- (1) Plus accrued interest, if any, from June 15, 1986.
- (2) See "Underwriting" for indemnification arrangements.
- (3) Before deducting estimated expenses of \$ payable by the Company.
- (4) The Company has granted to the Underwriters an option to purchase up to \$7,000,000 additional principal amount of Debentures at the Price to Public less the Underwriting Discounts and Commissions shown above, solely to cover over-allotments, if any. If the option is exercised in full, the total Price to Public, Underwriting Discounts and Commissions and Proceeds to Company will be \$, \$ and \$, respectively. See "Underwriting."

The Debentures offered hereby are being offered by the several Underwriters named herein, subject to prior sale and acceptance by the Underwriters and subject to their right to reject any order in whole or in part. It is expected that the Debentures will be available for delivery on or about June , 1986 at the offices of Wertheim & Co., Inc., New York, New York.

WERTHEIM & CO., INC.

BEAR, STEARNS & CO. INC.

SALOMON BROTHERS INC

June , 1986

A registration statement relating to these securities has been filed with the Securities and Exchange Commission but has not yet become effective. Information contained herein is subject to completion or amendment. These securities may not be sold nor may offers to buy be accepted prior to the time the registration statement becomes effective. This prospectus shall not constitute an offer to sell or the solicitation of an offer to buy nor shall there be any sale of these securities in any State in which such offer, solicitation or sale would be unlawful prior to registration or qualification under the securities laws of any such State.

No dealer, salesman or other person has been authorized to give any information or to make any representations other than those contained in this Prospectus in connection with the offering made hereby and, if given or made, such information or representations must not be relied upon as having been authorized by the Company or any Underwriter. This Prospectus does not constitute an offer to sell, or a solicitation of an offer to buy, any security other than the securities covered by this Prospectus, nor does it constitute an offer or solicitation by anyone in any jurisdiction in which such offer or solicitation is not authorized, or in which the person making such offer or solicitation is not qualified to do so, or to any person to whom it is unlawful to make such offer or solicitation. Neither the delivery of this Prospectus nor any sale hereunder shall under any circumstances create any implication that there has been no change in the affairs of the Company since the dates as of which information is furnished or the date hereof.

AVAILABLE INFORMATION

Crazy Eddie, Inc. (the "Company") is subject to the informational requirements of the Securities Exchange Act of 1934 and, in accordance therewith, files reports and other information with the Securities and Exchange Commission (the "Commission"). Such reports and other information can be inspected and copied at the public reference facilities maintained by the Commission at Room 1024, 450 Fifth Street, N.W., Washington, D.C.; Room 1204, Everett McKinley Dirksen Building, 219 South Dearborn Street, Chicago, Illinois; and Room 1028, Jacob K. Javits Federal Building, 26 Federal Plaza, New York, New York; and copies of such material can be obtained from the public reference section of the Commission at 450 Fifth Street, N.W., Washington, D.C. 20549, at prescribed rates.

This Prospectus, which constitutes part of a Registration Statement filed by the Company with the Commission under the Securities Act of 1933, omits certain of the information contained in the Registration Statement. Reference is hereby made to the Registration Statement and to the exhibits relating thereto for further information with respect to the Company and the securities offered hereby. Statements contained herein concerning the provisions of documents filed herewith as exhibits are necessarily summaries of such documents, and each such statement is qualified in its entirety by reference to the copy of the applicable document filed with the Commission.

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IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY OVER-ALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICE OF THE DEBENTURES OFFERED HEREBY AND THE COMMON STOCK OF THE COMPANY AT LEVELS ABOVE THOSE WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

SUMMARY

The following information is qualified in its entirety by the more detailed information and consolidated financial statements appearing elsewhere in this Prospectus. All share and per share amounts in this Prospectus have been adjusted to reflect the reorganization described under "Certain Transactions—Reorganization" and a two-for-one stock split effected in the form of a stock dividend paid on July 31, 1985.

THE COMPANY

The Company is a leading retailer of home entertainment and consumer electronic products in the New York metropolitan area, operating a chain of 24 retail stores located in New York, New Jersey and Connecticut. The Company promotes the "Crazy Eddie" name more than particular brand name merchandise or specific prices by aggressively advertising, primarily on radio and television, the low prices, customer service and product selection available to customers at each Crazy Eddie store. The Company has added twelve stores and closed one since January 1, 1984 and plans to accelerate its expansion program. Leases have been signed for stores at eleven new locations, seven of which are expected to open prior to March 1, 1987, and the remaining four of which are expected to open before the end of the 1987 calendar year. A twelfth new store, to be located at the Company's new headquarters facility in Edison, New Jersey, is expected to open prior to the end of 1986. The Company is actively negotiating a lease for one additional store.

THE OFFERING

Securities Offered \$65,000,000 principal amount of % Convertible Subordinated Debentures due June 15, 2011 (the "Debentures"). The Company has granted the Underwriters an over-allotment option to purchase up to an additional \$7,000,000 principal amount of Debentures.

NASDAQ Debenture Symbol CRZYG (proposed)

Terms of Debentures:

Interest Payments \$ annually per \$1,000 Debenture, payable semi-annually on June 15, and December 15, commencing December 15, 1986.

Conversion Each Debenture is convertible, at any time prior to maturity, unless previously redeemed, into shares of the Company's Common Stock at a conversion price of \$ per share, subject to adjustment in certain events.

Subordination The Debentures are subordinated in payment to all existing and future Senior Indebtedness, as defined in the Indenture.

Mandatory Sinking Fund 5% of the original aggregate principal amount annually beginning June 15, 1997, calculated to retire 70% of the Debentures prior to maturity.

Optional Redemption The Debentures are redeemable in whole or in part at any time at the Company's option at an initial redemption price of % of the principal amount prior to June 15, 1987 and thereafter at prices declining annually to 100% of the principal amount on or after June 15, 1996, except that the Debentures may not be so redeemed before June 15, 1988 unless the reported closing price of the Common Stock shall have equaled or exceeded 140% of the effective conversion price per share for any 20 trading days within a period of 30 consecutive trading days ending within 15 business days prior to notice of such redemption.

Use of Proceeds To be used for general corporate purposes, including opening new stores and providing working capital, and to finance possible acquisitions of related businesses.

SUMMARY CONSOLIDATED FINANCIAL DATA
(Dollar amounts in thousands, except ratios, per share and per square foot data)

	Year ended May 31,			Nine months ended March 3,	Year ended March 2,
	1982	1983	1984	1985	1986
Income Statement Data:					
Net sales	\$98,225	\$111,406	\$137,285	\$136,319	\$262,268
Income before pension contribution and income taxes	3,404	4,637	7,975	13,163	27,312
Net income	472	895	3,773	5,829	13,244
Earnings per share05	.09	.37	.48	.96
Ratio of earnings to fixed charges	1.87	3.24	7.99	13.70	12.34

Store Data:

Number of stores at end of period	10	12	13	15	23
Weighted average net sales per store	\$ 9,540	\$ 9,887	\$ 10,634	\$ 9,592	\$ 13,305
Net sales per square foot of selling area	1,699	1,886	2,118	1,890	2,903

	March 2, 1986	
	Actual	As Adjusted(1)
Balance Sheet Data:		
Working capital	\$ 29,810	\$130,314
Total assets	126,950	229,454
Long-term debt	7,701	72,701
Stockholders' equity	42,621	80,125

- (1) Adjusted to give effect to sale of 1,495,000 shares of Common Stock by the Company on March 7, 1986 and the application of the \$37,504,000 net proceeds therefrom and the sale of the Debentures offered hereby (assuming the Underwriters' over-allotment option is not exercised) and the application of the estimated net proceeds therefrom.

THE COMPANY

The Company is a leading retailer of home entertainment and consumer electronic products in the New York metropolitan area, operating a chain of 24 retail stores located in New York, New Jersey and Connecticut. Each of the Company's stores is operated under the Crazy Eddie name. The Company believes that the "Crazy Eddie" name has achieved strong consumer recognition in the Company's geographic market, and has adopted a marketing strategy that seeks to promote the Crazy Eddie name more than particular brand name merchandise or specific prices. The Company has sought to implement this strategy by aggressively advertising, primarily on radio and television, the low prices, customer service and product selection available to customers at each Crazy Eddie store.

The Company carries a broad range of products at each of its stores in order to provide customers with a wide selection of high quality, nationally recognized brand name merchandise, including products from Fisher, General Electric, Hitachi, Panasonic, Sony and Toshiba. Because of the purchasing power generated by the strong consumer recognition of the Crazy Eddie name in the Company's geographic market and by the sales volume of the Company's stores, the Company has been able to purchase such merchandise directly from manufacturers on terms that it believes to be more favorable, in many cases, than those offered to large retail department and specialty stores. The Company believes that its purchasing power enables it to offer such merchandise at prices generally below those offered by such other stores.

The Company has pursued a policy of growth through opening new stores and increasing sales volume from existing stores. The number of stores has increased from three in 1975, when the predecessor of the Company was formed, to 24 stores at the date of this Prospectus. The Company has opened 21 new stores (including one store that later closed and reopened at a nearby location) and closed one store since May 31, 1978, and currently intends to continue to expand by opening seven to ten additional stores during each of the next three years. The Company has signed leases for eleven stores of which seven are expected to open prior to March 1, 1987, and the remaining four of which are expected to open before the end of calendar year 1987. The Company is currently negotiating a lease for one additional store. The Company also expects to open before the end of 1986 a new store that will be part of the Company's new headquarters facility in Edison, New Jersey. All existing Crazy Eddie stores, as well as the stores expected to open before the end of 1987, are located within approximately 100 miles of the Company's new headquarters facility, which the Company expects to occupy no later than August 1986. See "Business—Planned Expansion."

The Company is the successor to Crazy Eddie, Inc., a New York corporation, which was merged into the Company prior to the consummation of the Company's initial public offering of Common Stock in September 1984 (the "Initial Public Offering") in order to change the corporate domicile to Delaware. The predecessor corporation was formed in 1975 as the parent entity of three Crazy Eddie stores. See "Certain Transactions—Reorganization."

The Company's executive offices are located at 2845 Coney Island Avenue, Brooklyn, New York 11235, telephone number (718) 934-0100. During the second quarter of its 1987 fiscal year, the Company expects to move its corporate headquarters to a new location in Edison, New Jersey. See "Business—New Facility." Unless the context otherwise requires, references to the "Company" relate to Crazy Eddie, Inc., its subsidiaries and their predecessors.

RECENT DEVELOPMENTS

On June 2, 1986, the Company reported net sales of \$64,500,000 for its first fiscal quarter ended June 1, 1986, a 41% increase over net sales of \$45,800,000 for the corresponding period of the Company's previous fiscal year. Comparable store sales (sales from stores that were open throughout the relevant periods) increased 10% for the quarter ended June 1, 1986. A total of 24 Crazy Eddie stores are currently in operation compared to 18 stores in operation in June 1985. The increases in net sales and comparable store sales reported by the Company are not necessarily indicative of financial results for the first fiscal quarter.

The Company sold 1,495,000 shares, and two directors of the Company sold an aggregate of 420,000 shares, of Common Stock in a public offering in March 1986. The Company raised approximately \$37,500,000 in that offering.

USE OF PROCEEDS

The proceeds from the sale of the Debentures offered by the Company (net of underwriting discounts and commissions and other expenses and assuming no exercise of the Underwriters' over-allotment option), estimated to be approximately \$, will be used for general corporate purposes including, but not limited to, opening new stores, financing the renovation and remodeling of existing stores and providing general working capital. A portion of the proceeds also may be used to finance the acquisition of related businesses if the Company identifies suitable prospects. As of the date of this Prospectus, there are no agreements or understandings, and the Company is not involved in any discussions or negotiations, with respect to any such acquisition. See "Business—Planned Expansion."

Pending utilization of the net proceeds as described above, the net proceeds will be invested in short-term securities, the yield on which may be less than interest costs on the Debentures offered hereby.

PRICE RANGE OF COMMON STOCK AND DIVIDEND POLICY

The Company's Common Stock is traded in the over-the-counter market (symbol: CRZY). Since February 12, 1985, the Company's Common Stock has been quoted on the NASDAQ National Market System.

The following table sets forth, for the calendar periods indicated, the high and low bid prices for the Company's Common Stock prior to February 12, 1985 (commencing on September 13, 1984, the date of the Initial Public Offering) and the high and low sale prices for the Company's Common Stock on the National Market System from and after such date, in each case as reported by National Quotation Bureau Incorporated. The bid prices reflect inter-dealer prices without retail mark-up, mark-down or commission and do not necessarily represent actual transactions. National Market System quotations, which began on February 12, 1985, are based on actual transactions and not bid prices. The quoted prices have been adjusted to give retroactive effect to a two-for-one stock split which the Company paid in the form of a one hundred percent stock dividend on July 31, 1985 to all stockholders of record on July 12, 1985 (the "Stock Dividend").

	<u>High</u>	<u>Low</u>
1984		
Third Quarter (from September 13, 1984)	\$ 5 ¹ / ₁₆	\$ 4 ¹ / ₂
Fourth Quarter	5 ¹³ / ₁₆	4 ⁵ / ₁₆
1985		
First Quarter	10 ¹³ / ₁₆	5 ⁷ / ₁₆
Second Quarter	15 ⁷ / ₁₆	9 ¹³ / ₁₆
Third Quarter	14 ¹ / ₂	10 ⁵ / ₈
Fourth Quarter	19 ¹ / ₄	11 ¹ / ₈
1986		
First Quarter	30 ¹ / ₄	18 ³ / ₈
Second Quarter*	37 ³ / ₈	26 ¹ / ₄

* Reflects prices through June 13, 1986.

The last sale price of the Common Stock as reported by NASDAQ on June 13, 1986 was \$34³/₄.

As of May 28, 1986, there were 725 holders of record of the Common Stock, excluding holders whose stock is held in nominee or street name by brokers.

The Company has never declared or paid any cash dividends on its Common Stock. The present policy of the Board of Directors is to retain earnings in order to provide funds for the expansion and development of the Company's business. Accordingly, the Company does not anticipate paying any cash dividends to the holders of the Common Stock in the foreseeable future.

CAPITALIZATION

The following table sets forth the capitalization of the Company at March 2, 1986 and as adjusted to give effect to the sale of 1,495,000 shares of Common Stock by the Company on March 7, 1986 and the application of the \$37,504,000 net proceeds therefrom and the issuance of the Debentures offered hereby (assuming no exercise of the Underwriters' over-allotment option) and the application of the estimated net proceeds therefrom of \$

	March 2, 1986	
	Actual	As Adjusted
	(In thousands)	
Short-Term Debt	\$ 2,254	\$ 2,254
Long-Term Debt:		
Economic Development Bonds(1)	\$ 7,701	\$ 7,701
Convertible Subordinated Debentures	—	65,000
Total Long-Term Debt	<u>7,701</u>	<u>72,701</u>
Stockholders' Equity:		
Preferred Stock, par value \$1.00 per share, 5,000,000 shares authorized, none issued	—	—
Common Stock, par value \$.01 per share, 50,000,000 shares authorized, 14,005,421 shares issued and 15,500,421 as adjusted(2)	140	155
Additional paid-in capital	17,808	55,297
Retained earnings	<u>24,673</u>	<u>24,673</u>
Total Stockholders' Equity	<u>42,621</u>	<u>80,125</u>
Total Capitalization	<u>\$50,322</u>	<u>\$152,826</u>

(1) On December 21, 1984, the Company obtained a \$7,800,000 loan from the New Jersey Economic Development Authority, the proceeds of which have been used to finance the construction of the Company's new headquarters facility in Edison, New Jersey that will include the Company's executive offices, a warehouse and distribution center, a central service center and a retail store. The loan bears interest at a rate equal to 75% of the prime rate of a commercial bank, subject to maximum and minimum interest rates per annum of 14% and 7½%, respectively, and is repayable in varying installments through 2015. See "Business—New Facility."

(2) Does not include (i) 376,700 shares reserved for issuance upon the exercise of options granted under the Crazy Eddie, Inc. 1984 Stock Option Plan (1,000,000 shares in the event an amendment to the plan is approved by the Company's stockholders at their annual meeting on July 22, 1986) and (ii) 61,379 shares reserved for issuance upon the exercise of certain warrants purchased by the representative of the underwriters in connection with the Initial Public Offering. See "Management—Stock Option Plan."

SELECTED CONSOLIDATED FINANCIAL DATA

The following table sets forth certain selected consolidated financial data with respect to the Company and is qualified in its entirety by reference to the financial statements and notes thereto included elsewhere in this Prospectus. All data included in this Prospectus have been restated, where applicable, to reflect the reorganization of the Company described under "Certain Transactions—Reorganization." See Note 1 of Notes to Consolidated Financial Statements.

The Company changed its fiscal year end from May 31 to the first Sunday in March, effective March 3, 1985.

	Year ended May 31,			Nine months ended March 3, 1985	Year ended March 2, 1986
	1982	1983	1984		
(Dollar and share amounts in thousands, except ratios, per share and per square foot data)					
INCOME STATEMENT DATA:					
Net Sales	\$98,225	\$111,406	\$137,285	\$136,319	\$262,268
Cost of Goods Sold	76,754	87,719	106,934	103,421	194,371
Gross Profit	21,471	23,687	30,351	32,898	67,897
Selling, General and Administrative Expense	18,061	19,194	22,560	20,508	42,975
Other Income	748	594	706	1,211	3,210
Interest Expense	754	450	522	438	820
Income Before Pension Contribution and Income Taxes	3,404	4,637	7,975	13,163	27,312
Pension Contribution(1)	2,377	2,507	—	600	800
Income Taxes	555	1,235	4,202	6,734	13,268
Net Income	\$ 472	\$ 895	\$ 3,773	\$ 5,829	\$ 13,244
Earnings Per Share(2)	\$.05	\$.09	\$.37	\$.48	\$.96
Weighted Average Number of Shares(2)	10,000	10,000	10,000	12,106	13,832
Ratio of Earnings to Fixed Charges(3)	1.87	3.24	7.99	13.70	12.34
BALANCE SHEET DATA					
AT PERIOD END:					
Current Assets	\$17,682	\$ 18,950	\$ 27,837	\$ 52,201	\$104,609
Current Liabilities	19,106	21,456	29,973	33,407	74,799
Working Capital (Deficiency)(4)	(1,424)	(2,506)	(2,136)	18,794	29,810
Total Assets	21,434	24,707	36,569	65,528	126,950
Long-Term Debt	106	70	46	7,625	7,701
Stockholders' Equity	2,057	2,951	6,224	23,861	42,621
STORE DATA:					
Number of stores at end of period	10	12	13	15	23
Weighted average net sales per store(5)	\$ 9,540	\$ 9,887	\$ 10,634	\$ 9,592	\$ 13,305
Net sales per square foot of selling area	1,699	1,886	2,118	1,890	2,903

(1) See Note 5 of Notes to Consolidated Financial Statements.

(2) Adjusted to give retroactive effect to the Stock Dividend.

(3) The ratio of earnings to fixed charges has been computed by dividing earnings (income before income taxes and fixed charges) by fixed charges. Fixed charges consist of interest on all indebtedness, amortization of debt-issuance expenses, discount on premium relating to indebtedness and one-third of rental expense.

(4) The Company's working capital deficiency during the period prior to the Initial Public Offering was a result of amounts owed to the Company by certain affiliated parties. Such amounts were repaid upon, and in one circumstance subsequent to, the consummation of the Initial Public Offering. See "Certain Transactions—Other Transactions."

(5) Weighted average net sales per store represents net sales for the period divided by the number of stores open during the period weighted to account for stores open for only a portion of the period.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following table sets forth, for the periods indicated, the relative percentage that certain items in the Company's Consolidated Statement of Operations bear to net sales:

	Income and Expense Items as a Percentage of Net Sales		
	Year ended May 31, 1984	Nine months ended March 3, 1985	Year ended March 2, 1986
Cost of Goods Sold	77.9%	75.9%	74.1%
Selling, General and Administrative Expense	16.4	15.0	16.4
Interest Expense4	.3	.3
Income Before Pension Contribution and Income Taxes	5.8	9.7	10.4
Pension Contribution	—	.4	.3
Income Taxes	3.1	4.9	5.0
Net Income	2.7	4.3	5.0

Results of Operations

Twelve Months Ended March 2, 1986 Compared to Twelve Months Ended March 3, 1985

Net sales for the year ended March 2, 1986 were \$262.3 million, representing an increase of \$95.1 million or 56.9% over the comparable period ended March 3, 1985. Of this increase, \$78.6 million resulted from the effect of additional stores in operation during the year ended March 2, 1986. Sales to affiliates decreased \$1.9 million during the year ended March 2, 1986. The balance of the increase (\$18.4 million) resulted from increased sales at the stores that were open throughout both periods. Comparable store sales for the 1986 fiscal year rose 17% over the prior year. Sales per square foot rose 22% during 1986 from \$2,368 to \$2,903 per square foot, while average sales per store rose 10% to \$13.3 million compared to \$12.0 million during the twelve months ended March 3, 1985. See Note 11 of Notes to Consolidated Financial Statements.

Gross profit (net sales less cost of goods sold) increased \$28.3 million for the year ended March 2, 1986, as compared with the twelve months ended March 3, 1985. This increase was primarily due to the increase in sales discussed above. Gross profit as a percentage of sales approximated 25.9% for the year ended March 2, 1986 as compared to 23.6% for the twelve months ended March 3, 1985. The additional working capital generated from operations and public offerings of the Company's common stock has enabled the Company to negotiate improved buying terms with many of the Company's vendors. In addition, the increase in sales of service contracts increased gross profit by approximately 1.0%.

Selling, general and administrative expenses increased by \$16.5 million during the year ended March 2, 1986, which increase principally reflects the costs of operating the eight new stores opened. The increase in the percentage of selling, general and administrative expenses to sales during the year ended March 2, 1986 (16.4% compared to 15.8% during the twelve months ended March 3, 1985) primarily resulted from the Company authorizing bonuses, writing off the cost of its existing computer system in light of the Company's planned installation of a new computer system, and writing off pre-opening costs on all new stores as incurred.

The effective tax rate for the year ended March 2, 1986 approximated 50.0% compared to 52.3% for the twelve months ended March 3, 1985. The reduction in the effective rate resulted from tax benefits in connection with the exercise of nonqualified stock options for which deferred taxes were not provided at the time the options were granted, and the reversal of tax reserves established prior to the Company's initial public offering, which are no longer required, in connection with various tax shelters. See Note 4 of Notes to Consolidated Financial Statements for an analysis of income tax expense.

Nine Months Ended March 3, 1985 Compared to Nine Months Ended February 29, 1984

Net sales for the nine months ended March 3, 1985 were \$136.3 million, representing an increase of \$29.9 million, or 28.1%, over the comparable period ended February 29, 1984. Of this increase, \$19.3 million resulted from the inclusion for the nine months ended March 3, 1985 of net sales attributable to

new stores and relocated stores not open for both periods. Sales to affiliates decreased \$1.4 million during the period. The balance of the increase (\$12.0 million) resulted from increased sales at the eleven stores that were open throughout both periods.

Gross profit (net sales less cost of goods sold) increased by \$9.1 million for the nine months ended March 3, 1985 compared to the comparable period ended February 29, 1984. Gross profit as a percentage of net sales approximated 24.1% for the nine months ended March 3, 1985 compared to 22.3% for the nine months ended February 29, 1984 as a result of improvements in purchasing.

Selling, general and administrative expenses increased by \$3.9 million during the nine months ended March 3, 1985 as compared with the nine months ended February 29, 1984. This increase was primarily due to the additional costs incurred at the new stores during the period. Selling, general and administrative expenses as a percentage of net sales approximated 15.0% and 15.6% for the nine months ended March 3, 1985 and February 29, 1984, respectively.

The Company authorized a \$600,000 contribution to its profit sharing plan for the nine months ended March 3, 1985. No contribution was required for the nine months ended February 29, 1984. See Note 5 of Notes to Consolidated Financial Statements.

The effective tax rate for the nine months ended March 3, 1985 approximated 53.6% compared to 55.0% for the nine months ended February 29, 1984. See Note 4 of Notes to Consolidated Financial Statements for an analysis of income tax expense.

Liquidity and Capital Resources

During the fiscal year ended March 2, 1986, the Company generated \$14.8 million in working capital from operations. During the nine months ended March 3, 1985 and the year ended May 31, 1984, \$6.2 million and \$4.2 million, respectively, in working capital was generated from operations. At March 2, 1986 and March 3, 1985, the Company had working capital of \$29.8 million and \$18.8 million, respectively. At May 31, 1984, the Company had a working capital deficiency of \$2.1 million.

During the nine months ended March 3, 1985 (prior to the Stock Dividend), the Company raised approximately \$11.8 million from its initial public offering of 1.7 million shares (3.4 million shares after giving retroactive effect to the Stock Dividend) of Common Stock completed in September 1984. On March 20, 1985, the Company sold to the public an additional 200,000 shares (400,000 shares after giving retroactive effect to the Stock Dividend) which raised approximately \$3.9 million.

In March 1986, the Company sold to the public 1,495,000 shares of common stock, which raised approximately \$37.0 million. Proceeds from these public offerings have been, and will continue to be, used for general corporate purposes including, but not limited to, opening new stores, financing the renovation and remodeling of existing stores and providing general working capital. In addition, a portion of such proceeds, together with other working capital of the Company, may be used to finance the acquisition of related businesses if the Company identifies suitable prospects. There are no agreements or understandings, and the Company is not involved in any discussion or negotiations, with respect to any such acquisition. Any additional funds necessary for expansion or acquisitions may be obtained through bank borrowings, internal sources or additional debt or equity offerings.

On December 21, 1984, the Company obtained a \$7.8 million loan from the New Jersey Economic Development Authority, the proceeds of which have been used to finance the construction of the Company's new headquarters facility in Edison, New Jersey. The loan bears interest at a rate equal to 75% of the prime rate of a commercial bank, subject to maximum and minimum interest rates per annum of 14% and 7½%, respectively, and is repayable in varying installments through 2015.

The Company recently terminated discussions with several institutional lenders pertaining to a proposed private placement by the Company of \$50,000,000 aggregate principal amount of ten-year senior notes. The institutional lenders have asked the Company for reimbursement of their expenses and for the benefits they would have received had the notes been issued. The Company has offered to reimburse the institutional lenders for their expenses and is awaiting their response.

United Jersey Bank has issued a \$10,000,000 letter of credit facility for the Company's benefit. \$2,000,000 of letters of credit are currently outstanding thereunder, bearing interest at ½ of 1%.

On June 10, 1986, the Company entered into an agreement with RepublicBank Dallas, National Association establishing a \$25,000,000 short-term credit facility with interest on amounts outstanding based on prime, certificate of deposit, LIBOR or money market fund rates. The agreement also provides for the issuance of letters of credit for the Company's benefit in an aggregate amount of not more than \$50,000,000 less amounts outstanding under the credit facility. No amounts are currently outstanding under the credit facility and no letters of credit have been issued.

In past years, the Company's capital expenditures, incurred principally in connection with the opening of new stores, were financed almost entirely out of internally generated funds and the proceeds of the Company's earlier public offerings. The Company intends to continue to use internally generated funds, together with a portion of the proceeds of this offering, to finance its expansion plans. Since March 2, 1986, the Company has opened two new stores in the Borough of Manhattan in New York City. The Company's current expansion plans include the opening of seven stores during the remainder of the 1987 fiscal year and four additional stores before the end of calendar 1987, as well as a twelfth new store at the Company's new headquarters facility in Edison, New Jersey, expected to open by the end of 1986. See "Business—Planned Expansion."

Impact of Inflation

In the Company's opinion, inflation has not had a material impact upon its operating results because technological advances in the type of products sold by the Company, together with increased competition among the Company's vendors, have kept the prices of such products stable and, in some instances, have caused the prices to decline.

BUSINESS

The Company sells home entertainment and consumer electronic products through a chain of 24 retail stores located in New York, New Jersey and Connecticut. All of the Company's stores are operated under the Crazy Eddie name, and are located in New York City or within the surrounding 100-mile radius. The Company believes that the "Crazy Eddie" name has achieved strong consumer recognition in the Company's geographic market. Accordingly, the Company has adopted a marketing strategy that seeks to promote the Crazy Eddie name more than particular brand name merchandise or specific prices. The Company has sought to implement this strategy by aggressively advertising, primarily on radio and television, the low prices, customer service and product selection available to customers at each Crazy Eddie store.

The Company carries a broad range of products at each of its stores in order to provide customers with a wide selection of high quality, nationally recognized brand name merchandise. Because of the purchasing power generated by the strong consumer recognition of the Crazy Eddie name in the Company's geographic market and by the sales volume of the Company's stores, the Company is able to purchase merchandise directly from manufacturers on terms that it believes to be more favorable, in many cases, than those offered to large retail department and specialty stores, thereby enabling the Company to offer such merchandise at prices that it believes to be generally below those offered by such other stores.

Although much of the merchandise carried by the Company is displayed in specialized fixtures or self-demonstrating audio and visual displays, the Company does not operate its stores in a "self-service" fashion and encourages its trained personnel to actively assist customers in selecting merchandise. In addition, each Crazy Eddie store has a service department on the premises, thereby enabling the Company in most cases to promptly service or repair its merchandise at the same location at which products were purchased by the Company's customers.

Because of the proximity of the Crazy Eddie stores to the Company's corporate headquarters, the Company is able to closely monitor its sales personnel as well as the sales results and operations at each of its stores. The Company believes that it is able to quickly assess changes in consumer tastes and preferences and to respond rapidly to such changes through its use of a central purchasing department and its employment of an in-house advertising staff.

Marketing and Sales

The Company believes that it has become a leading home entertainment and consumer electronics retailer in the geographic area in which it operates, and that it has achieved such status by virtue of the prices, selection and service offered at each of its Crazy Eddie stores.

A major factor in the Company's success has been its policy, publicized in daily advertisements, to price its merchandise below the prices that are typically offered by department stores, specialty stores and many other discount retailers. All products sold in Crazy Eddie stores carry a 30-day price guaranty pursuant to which the store will refund the difference between its sale price and any lower price for the same product that is demonstrated by the customer to be available at any other store.

The broad selection of products offered by the Company and the manner in which they are displayed enable the Company easily to change the variety and emphasis of its products and to expand displays of promotionally-priced or fast-moving items. This flexibility permits the Company to introduce new products, including products utilizing emerging technologies, and, at the same time, to maintain sales in existing product lines. Because the products sold by the Company attract customers of all ages, the Company does not focus its marketing efforts on any particular age group.

The Company views itself as being in a service business, and emphasizes to its sales personnel the need to provide personal attention to each customer. At each Crazy Eddie store, trained sales personnel are instructed to seek to assist customers in their purchases by demonstrating products and providing information desired by the customer with respect to price, quality and other matters. Highly visible displays of many products at each Crazy Eddie store promote sales by enabling sales personnel to demonstrate for customers the use of such products. In addition, the Company frequently utilizes in-store demonstrations of products by representatives of vendors.

Crazy Eddie stores are generally open seven days a week, from 10:00 a.m. to 10:00 p.m., Monday to Saturday, and noon to 5:00 p.m. on Sunday. The store located in Paramus, New Jersey is not open on Sunday. The Company's store hours are intended to make Crazy Eddie stores more accessible to customers than other stores selling similar goods, particularly for those customers who are unable to shop during ordinary business hours.

Advertising

The Company seeks to promote its prices, selection and service through an aggressive mass-media advertising campaign. Most of the Company's advertisements appear on radio and television, although the Company also advertises in New York City and certain local newspapers. The Company's radio and television advertising has as its theme "Crazy Eddie—His Prices Are Insane!"™, and advertisements feature a local radio announcer who seeks to convey to customers the Company's message of price, selection and service in an energetic and humorous manner.

Although the Company's advertising expenditures have increased from year to year, advertising expenditures as a percentage of net sales have declined as a result of the opening of new Crazy Eddie stores within the Company's "advertising umbrella" and of increased sales volume from existing stores.

The Company's advertising typically stresses promotional pricing, a broad assortment of merchandise, and the assistance provided by "professionally staffed service centers." Content, production and media placement (as well as lay-out and artwork in the case of newspaper advertising) are handled by an in-house advertising staff. The Company's approach is to be flexible in decisions regarding advertising and to make changes to advertising copy on short notice, where necessary, in order to publicize product promotions or to take advantage of new products or unexpected market developments.

Products

The size of a typical Crazy Eddie store enables it to offer a very broad selection in terms of both the breadth of products displayed and the selection within each product group. For example, a Crazy Eddie customer can choose from hundreds of models of audio components, television sets and car stereos manufactured by a wide variety of vendors. The Company sells over 500 brand names of merchandise, including Panasonic, General Electric, Sony, Hitachi, Toshiba and Fisher.

The Company's products may be grouped into the following seven groups: television and video, audio and audio systems, car stereo, portable and personal electronics, computers and games, accessories and tapes and miscellaneous items.

Television and video product group includes black and white televisions, portable color televisions, console color televisions, monitor televisions, AC/DC powered televisions, rear screen projection televisions, front projection televisions, television stands, component televisions, novelty televisions, portable and stationary video recorders, video cameras, video disc CED and Laser, video disc software, video enhancement devices, lighting systems and tripods.

Audio and audio systems product group includes home speakers, receivers, cassette decks, automatic and manual turntables, amplifiers, tuners, equalizers, signal processing, reverberation units, compact disc players, digital audio players, mini, midi and normal sized pre-packaged audio systems, open reel recorders, mixing boards, electronic musical keyboards, preamplifiers, compact music systems, headphones, microphones, power-amplifiers and integrated amplifiers.

Car stereo product group includes in-dash AM-FM cassette receivers, AM-FM cassette decks, tuners, preamplifiers, speakers, amplifiers, reverberation units, equalizers, antennas, installation hardware, boosters, car radios, car alarms and car telephones.

Portable and personal electronics product group includes portable radios, AC/DC portable recorders, AC/DC portable radio recorders, telephone answering recorders, portable telephones, standard and designer telephones, automatic telephone dialers, audio, video and computer furniture, home security devices, electronic typewriters, walkman-type radios, calculators, clock radios and micro cassette recorders.

Computers and games product group includes business and home computers, printers, floppy disc drives, data recorders, business and recreational software, computer monitors, electronic video games and software, and game joysticks.

Accessories and tapes product group includes cables, switches, phonograph cartridges and styli, audio and video tapes, storage boxes, blank audio tapes and blank video tapes, floppy discs, audio and video headcleaners, record cleaners, specialty audio records, tonearms, transformers and batteries.

Miscellaneous items product group includes microwave ovens, air conditioners, electric fans, small home appliances and other miscellaneous items, car stereo installation and extended warranty contracts offered by the Company for most audio, video and computer merchandise sold and for certain other items.

Based on a recent analysis by the Company of its sales by product group, the Company believes that the approximate percentage of its combined sales attributable to each of the foregoing product groups (except that the accessories and tapes product group has been combined with the miscellaneous items product group) is as follows:

<u>Product Group</u>	<u>Percentage of Total Sales</u>
Television and video	52%
Audio and audio systems	15
Portable and personal electronics	12
Computers and games	8
Accessories and tapes, and miscellaneous items	8
Car stereo	5
	<u>100%</u>

The percentage of sales accounted for during any period by each product group is affected by promotional activities, consumer trends and the development of new products. Management believes, however, that the Company is not dependent on any one product line or upon any single vendor or several major vendors, and that competitive sources of supply are available for all of the Company's merchandise.

Operations

Purchasing, personnel, accounting, advertising and merchandising management are centralized in the Company's corporate headquarters in Brooklyn, New York. During the second quarter of its 1987 fiscal year, the Company expects to move its corporate headquarters to a new location in Edison, New Jersey, which, in addition to providing more space, will house a retail outlet, a central service center and a central warehouse and distribution center. The existing Crazy Eddie stores, as well as the new stores scheduled to open before the end of 1987, will be within approximately 100 miles of the new corporate headquarters. See "Properties."

The Company generally purchases inventory directly from vendors who extend open lines of credit that are sometimes secured by the products sold. Substantially all inventory purchased by the Company is shipped directly to its central distribution facility in South Plainfield, New Jersey. Each Crazy Eddie store receives shipments of inventory from the central distribution facility several times a week, and often on a daily basis, thereby increasing convenience to customers by enabling each store to maintain substantial inventories of all products and to promptly replenish inventories of fast-moving products. Inventory turned over 5.53 times for the fiscal year ended May 31, 1984, 5.53 times for the nine months ended March 3, 1985, and 4.50 times for the year ended March 2, 1986.

Sales to customers are primarily made on a cash or major credit card basis. The Company accepts the following credit cards: Visa, MasterCard and American Express. Finance charges on credit card sales for the fiscal year ended March 2, 1986 approximated \$3,030,000, and approximated \$1,937,000 for the 12 months ended March 3, 1985.

Sales results for each store are generally available at the Company's corporate headquarters one day after sales occur. The daily sales reports, which are prepared manually by each salesperson and also are compiled by computer, enable management to review and analyze the performance of each of its salespersons. These reports also are used to manage central inventory and restock store inventories, and facilitate product pricing. A central purchasing department monitors current sales and tracks inventory on a daily basis. This department also performs all purchasing on behalf of the Crazy Eddie stores, thereby avoiding the need for individual stores to re-order merchandise when inventories of specific products need to be replenished.

Each Crazy Eddie store has its own complete management structure. In addition to a full-time store manager and assistant store manager (or in many cases two co-managers) at each location, each major department at a Crazy Eddie store has its own manager who reports to the store manager(s). Major departments include stock, television and video, personal electronics, computer, car stereo, and hi-fi and audio, although certain of such departments are combined in some of the Company's smaller stores. The Company's policy is to seek to staff store management positions from personnel within each store, and to staff new stores from its pool of trained managers. This policy, together with the historically low turnover of the Company's management personnel, has enabled the Company to develop an experienced management group. A majority of the Company's current store managers have been employed by the Company in this or other capacities for more than seven years.

The Company's management is typically in contact with the store managers on a daily basis, and seeks to monitor closely each store's operations. In addition, management meets with all of the store managers as a group, generally on a weekly basis, in order continually to emphasize the Company's philosophy of providing quality service to its customers and to discuss specific products, promotions, customer requests and other matters.

Although the Company's salespersons, numbering approximately 453 at June 5, 1986, generally develop a particular expertise with respect to specific products or a particular department, they receive extensive in-store training intended to enable them to demonstrate to customers the use and operation of all of the Company's merchandise and to service all of a customer's needs. Store managers are instructed to meet with, and continuously to monitor, their salespersons in order to promote good sales practices and also to train employees in the Company's operations and explain new products. Company manuals, advertising newsletters, video tape programs and presentations by management and manufacturers' representatives are utilized by the Company in its employee training. The Company attempts to motivate sales personnel by offering pension and profit sharing plans, a comprehensive medical insurance program and other employee benefits. Except in the case of sales of the Company's extended warranty plans, sales personnel are not paid on a commission basis. See "Employees" below.

All merchandise selected by a customer at a Crazy Eddie store (other than certain small items) must be written up by a salesperson before payment can be made at a central sales register located in each store. Substantially all items are picked up by the customer, after payment, from a separate stock department. Generally, all merchandise sold is taken by the customer directly from the store, with the exception of certain large televisions and consoles. The Company also offers delivery and installation service for certain of its products.

Merchandise sold may be exchanged for the same or other products or for store credit within seven days of the sale. The Company's policy is not to refund money paid. In addition, all products are sold with a 30-day price guaranty as described under "Marketing and Sales" above.

In addition to the service department located on the premises of each Crazy Eddie store, the Company employs approximately 50 full-time employees at a central service center which is utilized by each of the stores in those cases where more extensive servicing or repair is required. All merchandise sold by the Company is serviced and repaired either at the store service department or at the central service center, other than televisions which are sometimes sent to independent factory-authorized service stations and returned to the store after servicing or repair.

The Company offers its own extended warranty contracts for most audio, video and computer merchandise sold and for certain other items, pursuant to which the Company provides extended warranty coverage beyond the warranty period covered by the manufacturer. The Company performs the services required under the extended warranty contracts, except certain services which are performed by independent service companies selected by the Company. The Company also provides periodic maintenance services with respect to certain of its merchandise.

Properties

The 24 existing Crazy Eddie stores are all located within a 100-mile radius of New York City, and are situated on major commercial thoroughfares that are conveniently accessible to established urban neighborhoods or major residential areas in suburban neighborhoods. Sixteen of these stores are located in New York, six are in New Jersey and two are in Connecticut. The New York stores include ten stores in New York City (seven located in the Borough of Manhattan, two in the Borough of Queens and one in the Borough of Brooklyn), four in Long Island, one in Westchester County and one in Rockland County. The Company has signed leases for seven stores that are expected to open during the remainder of the 1987 fiscal year (of which one will be located in the Borough of Staten Island in New York City, four will be in New Jersey, one will be on Long Island and one will be in Poughkeepsie, New York) and four additional stores that are expected to open during the 1987 calendar year (of which three will be located in Connecticut and one will be located in New Jersey). The Company also expects to open a store at its new headquarters facility in Edison, New Jersey before the end of 1986.

The Company's general policy is to lease its stores in order to limit its investments in fixed assets and increase the availability of capital for other purposes; however, the Company has purchased a building that houses its store in Flushing in the Borough of Queens in New York City. All of the Crazy Eddie stores (other than the Flushing store) are leased from unrelated parties, except that the store located in Union, New Jersey is leased from Eddie Antar and Sam Antar, and the store located on East 86th Street in New York City is leased from a corporation controlled by the father-in-law of Sam E. Antar of the Company. The Company operates all of the space in each of its stores and does not lease any space to any third party concessionaires, other than pursuant to licensing agreements with Benel. See "Certain Transactions—Other Transactions." In addition, the Company has subleased to unrelated third parties a portion of the properties that the Company leases on Avenue of the Americas in New York City, and in Hartsdale and Massapequa, New York.

The Company's store leases, which (after giving effect to applicable renewal options) expire on various dates through the year 2011, in each case provide for a base rental and do not provide for a percentage of sales rental in addition to the fixed minimum rent. The leases are net leases requiring that, in addition to a fixed rent, the Company maintain and repair the leased premises at its own expense and pay all real estate taxes, utilities, insurance, heating and air conditioning costs. Rental payments (including amounts paid in respect of expenses, taxes and other charges) by the Company aggregated \$2,090,000 for the 12 months ended March 3, 1985 and \$4,554,000 for the fiscal year ended March 2, 1986. See Note 6 of Notes to Consolidated Financial Statements.

The table below sets forth certain information concerning the Company's 24 stores currently in operation and the locations of the Company's 12 new stores scheduled to open by the end of calendar year 1987:

<u>Stores in Operation</u>					
<u>Store Location</u>	<u>Calendar Year Opened</u>	<u>Approximate Selling Area (square feet)</u>	<u>Store Location</u>	<u>Calendar Year Opened</u>	<u>Approximate Selling Area (square feet)</u>
405 Ave. of the Americas New York, New York	1975	1,870	165 East 86th Street New York, New York(5)	1984	2,650
2067 Coney Island Avenue Brooklyn, New York(1)	1977	6,864	30 Jensen Street Fords, New Jersey	1984	2,920
809 Route 17 Paramus, New Jersey	1977	5,779	1000 Sunrise Highway Massapequa, New York	1985	3,240
269 Route 18 East Brunswick, New Jersey	1978	8,423	175 Rockland Center Nanuet, New York	1985	4,950
2155 Route 22 West Union, New Jersey(2)	1979	4,400	449 West Mount Pleasant Avenue Livingston, New Jersey	1985	2,616
393 North Central Avenue Hartsdale, New York	1979	6,692	89-22 Queens Boulevard Elmhurst, New York	1985	3,032
401 Old Country Road Carle Place, New York	1980	7,871	150 Broadway New York, New York	1985	4,625
212 East 57th Street New York, New York	1981	5,316	116 Boston Post Road Orange, Connecticut	1985	3,000
420-440 Westport Avenue Norwalk, Connecticut(3)	1983	3,959	25 West 45th Street New York, New York	1985	1,955
Route 46 West and Riverview Drive Totowa, New Jersey	1983	3,871	37-08 Main Street Flushing, New York(6)	1985	3,500
1010 Smithtown Bypass Nesconset, New York	1984	4,398	999 Third Avenue New York, New York	1986	1,591
350 Jericho Turnpike Syosset, New York(4)	1984	3,607	2186 Broadway New York, New York	1986	3,672
<u>New Stores</u>					
<u>Store Location</u>			<u>Store Location</u>		
Edison, New Jersey(7)			Toms River, New Jersey		
Princeton, New Jersey			Eatontown, New Jersey		
Stamford, Connecticut			Pleasantville, New Jersey		
Farmingdale, Connecticut			Staten Island, New York		
Hamden, Connecticut			Poughkeepsie, New York		
Cherry Hill, New Jersey			Valley Stream, New York		

(1) This store replaced an earlier store that was opened in 1973.

(2) This store is leased by the Company from Eddie Antar and Sam Antar. See "Certain Transactions—Other Transactions."

(3) During the night of December 26-27, 1985 there was a fire at this location which destroyed the contents of the store and substantially damaged its interior. The Company is fully insured for the losses that were sustained. The Company has reopened the store on a temporary basis at a nearby location, and hopes to reopen the store in expanded premises at its original location before the end of June 1986.

(footnotes continued on next page)

(footnotes continued from previous page)

- (4) This store, which opened in November 1984, replaced an earlier store that was opened in 1974 at a nearby location.
- (5) On March 31, 1984, the lease for a store at 1496 Third Avenue, New York, New York expired. Renewal of this lease was not possible and the Company decided to relocate such store to larger premises at this nearby site. The Company opened this store in September 1984. The store is leased from the father-in-law of Sam E. Antar, who was elected Controller of the Company in June 1985. The Company believes that the terms of this lease, which expires in April 1994, are no less favorable to the Company than the terms of similar leases of other stores entered into by the Company in arm's-length transactions with unaffiliated parties.
- (6) The Company has purchased the building in which this store is located, subject to an existing lease which expires in 1993 and which has been assigned to and assumed by the Company. As security for its obligations as assignee under such lease, the Company has executed a re-assignment and assumption of lease, which is being held in escrow.
- (7) This store is to be located at the Company's new corporate headquarters facility in Edison, New Jersey. See "New Facility" below.

On April 27, 1986, the Company closed its store located at 300 East Fordham Road, Bronx, New York. The Company has temporarily relocated its central service center from this location (where it occupied 3,800 square feet) to its warehouse facility in South Plainfield, New Jersey. The service center will relocate to the Company's new headquarters facility in Edison, New Jersey, when ready for occupancy. See "New Facility" below.

The following table sets forth the expiration dates (after giving effect to applicable renewal options), by calendar year, of the existing leases for the Company's stores.

<u>Calendar Years</u>	<u>Number of Store Leases Expiring</u>
1986-1988	1
1989-1991	3
1992-1994	2
1995-1997	6
1998-2001	11
2002-2004	2
2005-2007	7
2008-2011	2

The Company sub-subleases from Kelso Industries, Inc., a corporation wholly-owned by Eddie Antar and Sam Antar, a 20,000 square foot facility in Brooklyn, New York in which the Company currently has its corporate headquarters, which includes both its executive offices, purchasing, personnel, accounting, advertising and merchandising management departments. The sub-sublease expired March 30, 1986, at which time the Company exercised its option to renew the lease for a one-year term expiring March 30, 1987. The sublease is renewable for a one year term thereafter at the Company's option through March 30, 1988. The Company's rental payments under the sub-sublease are equal in amount to those that Kelso Industries pays to the sublessor.

The Company leases premises in close proximity to its current corporate headquarters which are used as a car stereo installation center. The Company also has leased 45,000 square feet of warehouse space in East Brunswick, New Jersey for a period of one year expiring November 10, 1986 to accommodate its increased storage requirements. In addition, a subsidiary of the Company leases premises in the Borough of Manhattan in the City of New York which serve as a showroom and provide offices for the subsidiary's professional audio and video installation business.

New Facility

On April 11, 1984, the Company entered into agreements to purchase approximately 11 acres of land in Edison, New Jersey and to have a builder construct the Company's new corporate headquarters on such land. The agreements were conditioned, among other things, upon the Company receiving from the New Jersey Economic Development Authority (the "Authority") approval for the issuance of economic development bonds to finance such acquisition and construction as well as certain related costs.

On December 21, 1984, the Company borrowed from the Authority the aggregate amount of \$7,800,000 in order to finance the acquisition of the land and certain related machinery and equipment and construction of the new facility. The proceeds for such loan were provided pursuant to the issuance by the Authority of \$6,200,000 aggregate principal amount of its Series A Economic Development Bonds (Crazy Eddie, Inc.—1984 Project) (the "Series A Bonds") and \$1,600,000 aggregate principal amount of its Series B Economic Development Bonds (Crazy Eddie, Inc.—1984 Project) (the "Series B Bonds" and, together with the Series A Bonds, the "Bonds"). On May 1, the Authority re-allocated \$1,000,000 from the Series "B" Bonds to the Series "A" Bonds. As of that date, the aggregate principal for Series "A" was \$7,200,000 and for Series "B" was \$600,000. Pursuant to a loan agreement between the Authority and the Company, the Company is obligated to make principal and interest payments in respect of the loan in amounts sufficient to pay the amounts of principal and interest due from time to time on the Bonds. The Bonds bear interest at a rate equal to 75% of the rate of interest announced from time to time by Midlantic National Bank as its prime rate, but such rate may in no event exceed 14% or be less than 7½% per annum. The principal amount of the Series A Bonds is payable in consecutive quarterly installments of approximately \$51,667, commencing January 1, 1986 to and including July 1, 2015. The principal amount of the Series B Bonds is payable in consecutive monthly installments of approximately \$19,048, commencing August 1, 1985 to and including January 1, 1992. As a result of the re-allocation on May 1, a portion of the monthly payments made with respect to the Series B Bonds will be applied toward amortization of the principal amount of the Series A Bonds.

As security for repayment of the Bonds and the performance by the Company of its obligations under the loan agreement with the Authority, the Company has granted to the Authority a first mortgage lien on the new facility and a security interest in, among other things, all leases that are entered into by the Company with any tenant of the facility (including all rents payable to the Company thereunder).

Construction of the facility commenced in early 1985 and has been completed. The Company expects that the move to Edison, New Jersey will occur during the second quarter of the 1987 fiscal year after certain interior renovations have been made. It had been expected that the construction and relocation would have been completed during 1985; however, the relocation has been postponed by certain construction delays and by changes that were required to be made to the facility in order to accommodate the recent accelerated and expected growth of the Company. The Company anticipates that its total cost for such move, including costs associated with the purchase and construction of the new facility and related relocation expenses, will be approximately \$9,500,000. The existing Crazy Eddie stores, as well as currently planned new stores, will be within approximately 100 miles of the new corporate headquarters. The new location will have approximately 210,000 square feet of space, of which 175,000 square feet will house the Company's executive offices, a retail store, a central service center and a warehouse and distribution center. It is expected that the remaining space will be leased by the Company on a short-term basis to Benel. The Company does not expect such relocation to result in any interruption of the Company's normal business operations and procedures.

Planned Expansion

The Company has signed leases for eleven additional stores, seven of which are expected to open during the remainder of the 1987 fiscal year, and the remaining four of which are expected to open before the end of the 1987 calendar year. A twelfth new store is scheduled to open before the end of 1986 at the Company's new headquarters facility in Edison, New Jersey. The Company is actively negotiating a lease for one additional store.

Costs associated with the opening of any new Crazy Eddie store are currently estimated by the Company to approximate \$1,350,000, including costs of leasehold improvements, fixtures, equipment and inventory. This estimated cost would likely decrease in those cases where the Company is not required to make significant leasehold improvements, and would likely increase if it were necessary to renovate substantially or convert previously used space. In addition, other economic conditions not within the control of the Company, such as inflation, could result in increased store opening costs in the future. The Company employs three persons who historically have handled the bulk of the work associated with the refurbishing of the interior of new stores, and believes that its use of such in-house personnel results in significant cost savings in connection with the acquisition and opening of additional stores. As a result of the Company's accelerated expansion, however, an increasing amount of such work is being subcontracted out to third parties. None of the subcontracted work is performed by affiliated companies.

The Company's current expansion objective is to focus on the geographic market within a 100-mile radius of New York City in order to continue to take advantage of the Company's "advertising umbrella" provided by extensive radio and television advertising and other efficiencies and cost savings that have been realized by the Company as a result of its geographic concentration of stores, such as the Company's ability to service all Crazy Eddie stores through central warehouse and repair facilities, to shift personnel among the stores as needed and to have its executives visit any store location on short notice. Opening additional stores in the Company's existing market has enabled the Company to increase market penetration and increase pretax earnings by reducing overhead and advertising cost as a percentage of sales in that market. The Company anticipates, however, that some future stores will be located in areas that are extensions of the Company's present geographic market. See "Advertising" above.

The Company has opened 21 new stores since May 31, 1978 (including one store in New York City that later closed and reopened at a nearby location), and currently intends to continue to expand by opening seven to ten additional stores during each of the next four years. As noted above, the Company has signed leases for eleven new stores and is actively negotiating a lease for one other, and expects to open an additional new store at its new headquarters facility in Edison, New Jersey. Management is continuously seeking new store locations available for lease and believes that it will be able to locate within its desired geographic market a number of available locations suitable for additional stores sufficient to enable the Company to fulfill its current expansion plans. There can be no assurance, however, that desirable locations with suitable structures will continue to be available, or if available will be obtained on favorable lease or purchase terms. Because of the number of trained managers at the existing Crazy Eddie stores, the Company believes that it has developed a pool from which to staff management of any additional stores.

Implementation of the Company's expansion plan is dependent on future business conditions. Expansion also will depend on the Company's ability to locate within its geographic market suitable sites for Crazy Eddie stores, and on the availability of funds. A portion of the net proceeds to the Company from the offering made hereby will be used to fund costs associated with the opening of some or all of the new stores referred to above, and also may be used to fund future expansion. Any additional funds necessary for expansion may be obtained through bank borrowings, internal sources or additional debt or equity offerings. To the extent sufficient funds are not available from such sources, the Company may not be able to fulfill its expansion objectives. See "Capitalization."

Seasonality

Historically, the Company has realized greater sales during the Christmas season than in other fiscal quarters of the year. The Company's marketing strategy and, in particular, its steady use of radio and television advertising is intended to minimize the seasonality of the Company's sales. See Note 12 of Notes to Consolidated Financial Statements for net sales and other quarterly financial data of the Company.

Servicemarks

The "Crazy Eddie," "Record and Tape Asylums," "Crazy Eddie Record and Tape Asylums" and "His Prices Are Insane" marks, and the Company's logo, are servicemarks registered with the United

States Patent and Trademark Office and owned by the Company. The "Crazy Eddie" and "His Prices Are Insane" marks, as well as the Company's logo, are an integral part of the Company's advertising and important to the Company's business. The "Crazy Eddie Record and Tape Asylums" and certain other of the Company's servicemarks are licensed by the Company for use by Benel. See "Certain Transactions—Other Transactions."

Competition

The business of the Company is highly competitive in that there are many retailers that sell one or more of the products carried by the Company. The Company competes with department stores, discount stores, catalog showrooms, specialty stores and other retailers. To some extent, the Company also competes with drugstores, supermarkets and others that make incidental sales of electronic products. Some of the Company's competitors are national in scope and have greater financial resources than the Company.

The Company competes principally by aggressively advertising its broad selection of merchandise, low prices and customer service, and believes that it has become the most visible home entertainment and consumer electronics retailer in its geographic market by virtue of the widespread consumer recognition of the "Crazy Eddie" name. In addition, the Company believes that its sales volume, together with the consumer recognition of its name, provides the Company with significant purchasing power. The Company seeks to take advantage of such purchasing power by negotiating for favorable pricing and other terms with the manufacturers of its merchandise, which in turn permits the Company to sell such merchandise to customers at prices that it believes to be lower than those offered by most of its competitors.

Employees

At June 5, 1986, the Company employed 1,558 persons, of whom 270 were salaried and 1,288 were compensated on an hourly basis. Approximately 190 of its employees are employed in the Company's corporate headquarters and central service center; the balance are employed in the stores. Except as noted under "Operations" above, no sales personnel are paid on a commission basis. Substantially all of the Company's employees are employed full-time. The Company has never experienced a strike or work stoppage and management believes that its employee relations are good. There are no collective bargaining agreements covering any of the Company's employees.

Legal Proceedings

Except as described in the following paragraph, the Company is not a party to any material legal proceedings. It is, however, involved in litigation relating to claims arising out of its operations in the normal course of business. Such claims against the Company are generally covered by insurance. It is the opinion of management that any uninsured or unindemnified liability resulting from such litigation would not have a material adverse effect on the Company's business or financial position.

The Company is a defendant in *Gerald Newman v. Crazy Eddie, Inc.*, an action filed in the New York Supreme Court, Westchester County, in September 1984. The plaintiff sought damages in the aggregate amount of \$3,600,000 based upon an alleged agreement in or about October 1983 between himself and the Company relating to services to be performed by the plaintiff in connection with a proposed public offering of the Company's stock. On April 21, 1986, the Appellate Division of the New York Supreme Court unanimously upheld the decision of the lower court granting summary judgment in favor of the Company.

MANAGEMENT

Directors and Executive Officers

The Company's directors and executive officers are as follows:

<u>Name</u>	<u>Age</u>	<u>Positions with the Company</u>
Eddie Antar	38	Chairman of the Board, President and Chief Executive Officer
Sam Antar	65	Director, Executive Vice President
Mitchell Antar	30	Director, Executive Vice President—Marketing
Eddy Antar	60	Director, Treasurer
James H. Scott, Jr.	41	Director
Carl G. Zimel	41	Director
Solomon E. Antar	48	Secretary and General Counsel
David Pardo	32	Executive Vice President—Purchasing
Morton Gindi	39	Vice President—Operations
David V. Panoff	37	Vice President—Consumer Service Operations
Sam E. Antar	29	Controller

The Company's directors hold office until the next annual meeting of stockholders or until their successors have been duly elected and qualified. The Company's officers, other than Eddie Antar, are elected annually by the Board of Directors and hold office at the pleasure of the Board. The Company has entered into an employment agreement with Eddie Antar. See "Executive Compensation."

Eddie Antar and Mitchell Antar are brothers, and are sons of Sam Antar. Eddy Antar and Sam Antar are brothers. Solomon E. Antar is a cousin of Sam Antar and Eddy Antar. Morton Gindi is a cousin of Eddie Antar, Mitchell Antar and Sam E. Antar. Sam E. Antar is the son of Eddy Antar.

Eddie Antar has served as a director and President of the Company and its predecessors since its inception and was elected Chairman of the Board, President and Chief Executive Officer in May 1984.

Sam Antar has served as a director and Vice President of the Company and its predecessors since its inception and was elected Executive Vice President in May 1984. Shoe Time, Inc., an Arizona corporation which operates discount shoe stores in the State of Arizona and in which Sam Antar has a 50% equity interest, filed a petition under the federal bankruptcy laws on June 13, 1983.

Mitchell Antar was elected Executive Vice President—Marketing in June 1985 and has been a director since May 1984. Prior to that time, he served the Company as Vice President—Purchasing and in other capacities relating to purchasing and store operations.

Eddy Antar was elected a director and Treasurer in May 1984. Prior to that time, he served as the Secretary and Treasurer of the Company.

James H. Scott, Jr. was elected a director in October 1984. Since 1983, Mr. Scott has been a Professor of Finance at the Columbia University Graduate School of Business. Prior to that time, he was an Associate Professor. Mr. Scott was on leave from Columbia University from August 1981 through June 1982, during which time he was employed at McKinsey & Co. until January 1982 and then in the Corporate Finance Department at Goldman, Sachs & Co.

Carl G. Zimel was elected a director in May 1984. Mr. Zimel has been a Senior Vice President of Alaska National Bank of the North since January 27, 1986. Prior to that time, he served as a Vice President, and later as a Senior Vice President in charge of branch administration and operations, of Midland Bank and Trust Co. in Paramus, New Jersey. Midland Bank and Trust Co. has issued for the account of the Company various letters of credit aggregating approximately \$501,850 in connection with certain of the Company's leases.

Solomon E. Antar was elected Secretary and General Counsel in May 1984. Prior to that time, he served as the Company's General Counsel.

David Pardo, Morton Gindi, David V. Panoff and Sam E. Antar were elected to their present positions on June 24, 1985 and, other than Sam E. Antar, each has been employed by the Company for more than five years. Prior to commencing employment with the Company in July 1984, Sam E. Antar was employed for three years by Penn and Horowitz (predecessor of J. Liebman & Co.), independent certified public accountants. Sam E. Antar is a certified public accountant.

Executive Compensation

The following table sets forth all cash compensation paid by the Company during the fiscal year ended March 2, 1986 to (i) each of the Company's five most highly compensated executive officers and (ii) all executive officers of the Company as a group:

<u>Name of Individual or Number in Group</u>	<u>Capacities in Which Served</u>	<u>Cash Compensation for the Year Ended March 2, 1986(1)</u>
Eddie Antar	Chairman of the Board, President and Chief Executive Officer	\$ 300,000(2)
Sam Antar	Executive Vice President	200,000
Mitchell Antar	Vice President—Purchasing	143,000
Morton Gindi	Vice President—Operations	101,800
Sam E. Antar	Controller	108,600
Executive officers as a group (9 persons)		1,101,900

- (1) The table does not include any amounts for personal benefits because the dollar amount cannot be specifically ascertained, and the Company does not believe that in any individual's case such value would equal or exceed the lesser of \$25,000 or 10% of such individual's cash compensation shown above or that, with respect to the group, the aggregate amount of such value would exceed the lesser of \$225,000 or 10% of aggregate cash compensation shown above for the group.
- (2) The base salary of Eddie Antar may be increased during the current fiscal year. See "Employment Agreement" below.

Members of the Board of Directors who are not employees of the Company are paid a fee of \$12,000 per annum for their services as directors.

Employment Agreement

The development of the Company's business has been dependent to a large extent upon Eddie Antar, its Chairman of the Board, President and Chief Executive Officer and a principal stockholder. The Company believes that it has developed an experienced management group; however, no assurance can be given that the Company's operations would remain unaffected if, for any reason, Eddie Antar does not continue to be active in the Company's management. The Company entered into an employment agreement with Eddie Antar, effective as of June 1, 1984 (the "Employment Agreement"), providing for the employment of Mr. Antar as the Chief Executive Officer of the Company at an initial annual base salary of \$300,000. Since June 1, 1985, Mr. Antar has been eligible to receive increases in base salary and bonuses as determined by the Board of Directors. The Employment Agreement does not obligate the Company to increase Mr. Antar's base salary but, if it does so, it cannot thereafter reduce such base salary. At a meeting held on March 4, 1986, the Board postponed consideration of an increase in the annual base salary of Eddie Antar until its meeting to be held in conjunction with the 1986 Annual Meeting of Stockholders. Any such increase approved by the Board at that time will not be retroactive, and Mr. Antar will continue to receive until that time an annual base salary of \$300,000.

Unless otherwise terminated by the Company as provided in the Employment Agreement, Mr. Antar's term of full-time employment will continue until the earlier of (i) the fifth anniversary of receipt of a notice of termination given by the Company or Mr. Antar to the other or (ii) the first anniversary of receipt of a notice of termination given by Mr. Antar to the Company on or after Mr. Antar's 59th birthday, except that the term of Mr. Antar's full-time employment may in no event extend beyond the

day next preceding the Annual Meeting of Stockholders of the Company next following the date of Mr. Antar's 65th birthday. The Employment Agreement obligates Mr. Antar to provide certain advisory services to the Company during the five-year period following Mr. Antar's term of full-time employment (the "Advisory Period"), for which Mr. Antar will receive annual compensation in an amount equal to not less than 40% of his final base salary.

The Employment Agreement also provides that in the event of a change in control of the Company, Mr. Antar may terminate his term of full-time employment thereunder. In such event, unless (i) Mr. Antar accepts an employment agreement with the Company or any successor or (ii) such change in control was initiated by the Company or was supported from the outset by the Board of Directors of the Company and Mr. Antar is offered a contract at least as favorable as the Employment Agreement, Mr. Antar would be entitled for a period of five years after such termination to his annual compensation and to the other benefits provided for in the Employment Agreement during the term of his full-time employment, and thereafter to the compensation and other benefits he would otherwise be entitled to receive during the Advisory Period, or, in lieu thereof, to the present value of such compensation and benefits.

The Company owns and is the beneficiary of life insurance policies on the life of Eddie Antar in the amount of \$5,000,000.

On February 18, 1986, the Board of Directors delegated to Eddie Antar authority to fix the compensation of all other officers of the Company.

Stock Option Plan

The Company's 1984 Stock Option Plan (the "Option Plan") was adopted by the Board of Directors and approved by the stockholders prior to the Initial Public Offering. A total of 500,000 shares of Common Stock (as adjusted to give effect to the Stock Dividend) were reserved for issuance under the Option Plan. The Option Plan provides for the granting to key employees of both "incentive stock options," within the meaning of section 422A of the Internal Revenue Code of 1954, as amended from time to time (the "Code"), and "nonqualified stock options."

The Option Plan provides for administration by a committee (the "Committee"), consisting of three persons appointed by the Board of Directors, which will determine, by unanimous vote, the key employees to be granted options under the Option Plan, the number of shares subject to each option and the option price, and which will specify whether options granted are incentive stock options or nonqualified stock options. Members of the Committee will not be eligible to receive options under the Option Plan. No options granted under the Option Plan will be transferable by the optionee other than by will or by the laws of descent and distribution, and each option will be exercisable, during the lifetime of the optionee, only by the optionee. Options granted to employees generally terminate three months after the optionee's termination of employment except in cases of (i) disability occurring while employed or (ii) death while employed or within three months thereafter. No options may be granted under the Option Plan commencing ten years after adoption of the Option Plan.

The exercise price of any incentive stock option granted under the Option Plan shall be not less than the fair market value of the shares subject to the option on the date of grant. The exercise price of any nonqualified stock option granted under the Option Plan shall be not less than 85% of the fair market value of the shares subject to the option on the date of grant. The term of each option and the manner in which it may be exercised will be determined by the Committee, subject to the requirements that no option may be exercisable more than 10 years after the date of grant. With respect to any incentive stock option granted to an employee who owns stock possessing more than 10% of the voting rights of the Company's outstanding capital stock on the date of grant, the exercise price of the option must be at least equal to 110% of the fair market value of the shares subject to the option on the date of grant and the option may not be exercisable more than five years after the date of grant. The aggregate fair market value of the Common Stock (determined at the date of the option grant) for which any employee may be granted incentive stock options under the Option Plan in any calendar year may not exceed \$100,000, plus certain permissible carryover allowances. The Option Plan permits the exercise of options either by a cash payment or, with the consent of the Committee, by surrender of

shares of Common Stock, valued at fair market value at the date of surrender, or a combination of these methods.

Stock options to purchase an aggregate of 132,100 shares of Common Stock were granted to seven officers and 57 other employees on September 21, 1984 at an exercise price of \$8.29 per share (being 85% of the closing bid price on such date for the Common Stock as reported by NASDAQ) (the "1984 Options"). On September 21, 1985, the Committee, pursuant to the Option Plan, adjusted the 1984 Options for the effects of the Stock Dividend by increasing the number of shares subject to each such option by 100%, and reducing the exercise price to \$4.15 per share. Such options are exercisable in whole or in part at any time prior to September 21, 1994.

Stock options to purchase an aggregate of 22,000 shares of Common Stock were granted to three officers on October 8, 1985 at an exercise price of \$11.63 per share (the last sales price on such date as reported by NASDAQ). Stock options to purchase an aggregate of 188,750 shares of Common Stock were granted to seven officers and 85 other employees on October 8, 1985 at an exercise price of \$9.88 per share (being 85% of the last sales price on such date as reported by NASDAQ). None of the options subject to such grants may be exercised prior to April 11, 1986 or after October 7, 1995.

The following table sets forth the number of shares of Common Stock subject to outstanding stock options granted under the Option Plan to (i) each of the individuals named in the table under "Executive Compensation" and (ii) all executive officers of the Company as a group:

<u>Name of Individual or Number in Group</u>	<u>Shares Subject to September 21, 1984 Stock Options</u>	<u>Shares Subject to October 8, 1985 Stock Options</u>
Mitchell Antar	20,500	10,000
Morton Gindi	—	8,500
Sam E. Antar	10,000	10,000
Executive officers as a group (nine persons) ...	58,500	47,000

None of the Company's executive officers exercised any options during the nine months ended March 3, 1985. Options for 20,500 shares were exercised by David Pardo in September 1985 and approximately \$246,000 was realized upon the subsequent sale of the shares acquired pursuant to such options. Options for 10,000 shares were exercised by Morton Gindi in January 1986; the shares acquired as a result of such exercise have not yet been sold. In April 1986, David V. Panoff and Solomon E. Antar exercised options for 2,500 shares and 10,000 shares respectively, pursuant to options granted on September 21, 1984. Also in April 1986, David Pardo and Solomon E. Antar exercised options for 10,000 shares and 8,500 shares, respectively, pursuant to options granted on October 8, 1985. The shares acquired as a result of such exercises in April 1986 have not yet been sold.

A registration statement under the Securities Act of 1933, as amended, with respect to shares issued or reserved for issuance under the Option Plan has been filed by the Company and was declared effective by the Commission in April 1985.

Because options for only 25,050 shares of Common Stock under the Option Plan remain available for grant, the Company is seeking stockholder approval at its 1986 Annual Meeting of Stockholders to be held on July 22, 1986 of a new stock option plan that will provide for the granting of options for up to 1,000,000 shares of Common Stock.

Money Purchase Pension Plan

The Company formerly maintained a money purchase pension plan (the "Money Purchase Plan") which was terminated effective as of May 31, 1984. All participants in the Money Purchase Plan at that date became fully vested in their account balances. The Internal Revenue Service approved the termination of the Money Purchase Plan on May 20, 1985 and all account balances held in trust under the Money Purchase Plan have been distributed to the participants. The Company contributed annually to the Money Purchase Plan, on behalf of each eligible participant, an amount equal to 25% of each participant's W-2 compensation for the immediately preceding calendar year. A portion of Company contributions was invested in insurance policies issued on the lives of the participants.

The following table sets forth the amount of distributions of account balances previously held in trust under the Money Purchase Plan that have been made (i) to each of the individuals named in the table under "Executive Compensation" and (ii) to all executive officers of the Company as a group:

<u>Name of Individual or Number in Group</u>	<u>Amount of Distribution</u>
Eddie Antar	\$ 267,001
Sam Antar	422,629(1)
Mitchell Antar	197,013
Morton Gindi	54,930
Sam E. Antar	10,629
Executive officers as a group (nine persons)	1,187,909(1)

(1) Includes (i) \$95,555 which was offset against outstanding borrowings made by Sam Antar against his account and (ii) \$170,414 distributed to Rose Antar, the wife of Sam Antar.

Profit Sharing Plan

The Company adopted, effective as of June 1, 1984, a profit sharing plan (the "Profit Sharing Plan") for all employees who have completed a year of service and attained age 21. The Company shall contribute annually to the Profit Sharing Plan an amount up to \$1,000,000, out of the Company's net profits, to be determined by the Board of Directors in its sole discretion. Individual accounts will be established for each participant. Contributions and forfeitures shall be allocated to the accounts of participants who have completed a year of service and are employed by the Company on the last day of the plan year according to the proportion that each participant's total compensation from the Company for the plan year bears to the aggregate compensation of all participants for the plan year. The annual additions to a participant's account (including Company contributions, forfeitures and the lesser of participant contributions in excess of 6% of the participant's compensation or one-half of the participant's contributions) for any plan year are limited to the lesser of \$30,000 or 25% of the participant's compensation.

A participant will vest in 30% of his account balance on the completion of three years of vesting service, increasing by 10% for each year of vesting service thereafter until full vesting occurs after ten years. A participant will become 100% vested in his account on his reaching age 65, his retirement due to disability, or his death. If a participant continues as an employee after reaching age 65, contributions will continue to be allocated to his account until his actual retirement. The nonvested portion of a terminated participant's account will be forfeited by him. By the terms of the Profit Sharing Plan, forfeitures are reallocated to the accounts of the remaining participants.

A participant may make voluntary contributions to a separate account, which shall not, when added to voluntary contributions made to any other plan of the Company, exceed 10% of the participant's base compensation. The participant will at all times have a 100% nonforfeitable right in his voluntary contribution account.

Benefit distributions under the Profit Sharing Plan will be in the form of lump sums. Death benefit distributions may be delayed up to five years following the participant's death. A participant who terminates employment prior to age 65, disability or death, may receive his vested benefits on reaching 65, or his beneficiaries may receive benefits following his death. At the participant's request, the administrative committee, in its sole discretion, may allow the distribution of a terminated participant's vested benefits upon his termination from service. A year of service under the Profit Sharing Plan is a 12 consecutive month period during which an employee is credited with at least 1,000 hours of service. A year of vesting service under the Profit Sharing Plan is a plan year (June 1 to May 31) during which an employee is credited with at least 1,000 hours of service. Years of vesting service under the Profit Sharing Plan will include years of service credited under the terminated Money Purchase Plan.

Effective prior to the date of the Company's contribution to the Profit Sharing Plan for the plan year ended May 31, 1986, the executive officers of the Company agreed to waive their participation in the Profit Sharing Plan for such plan year.

Defined Benefit Pension Plan

The Company and its subsidiaries adopted a defined benefit pension plan (the "Pension Plan"), effective as of June 1, 1979, for all employees with at least six months of service who have attained age 24. The Company is required to make annual contributions to the Pension Plan in such amounts as are actuarially required to fund the benefits of the participants under the Pension Plan. As a result of the current funding status of the Pension Plan, it is anticipated that the Company will not be required to make any contributions to the Pension Plan for the current year, and the Company expects that it will terminate the Pension Plan prior to the time contributions again become required.

At present, each participant who retires on his normal retirement date (the later of the June 1st nearest to his 65th birthday or the 10th anniversary of his entry into the Pension Plan) is entitled to a monthly pension benefit equal to 22.132% of his average monthly compensation (over his highest paid five consecutive year period of participation) in excess of \$1,908. For purposes of the Pension Plan, "monthly compensation" includes bonuses, overtime and commissions, but excludes any deferred compensation. The participant's monthly pension benefit is reduced pro rata if the participant has been employed by the Company for less than 15 years at his normal retirement date. The Pension Plan provides a minimum monthly pension benefit of \$20.00 for any participant who has accrued a benefit under the basic formula.

A participant who terminates employment before his normal retirement date vests in his accrued benefit as follows: 30% vesting after completion of three years of service, with an additional 10% vesting for each additional year of service until 100% vesting is achieved after ten years. All participants in the Pension Plan will become fully vested in their accrued benefits upon the termination or discontinuance of the Pension Plan. The Pension Plan provides a death benefit, funded by life insurance, equal to 100 times the monthly pension to which a participant is entitled. Benefit distributions to married participants will be in the form of a qualified joint and survivor annuity unless an optional benefit form is chosen. Optional benefit forms include a lump sum payment, other forms of annuity contracts, and substantially equal annual (or more frequent) installments over a specified period of time.

Participants may, but are not required to, make voluntary contributions to individual accounts established under the Pension Plan in an amount which, when added to voluntary contributions under all other Company plans, does not exceed 10% of the participant's compensation. Participants are always fully vested in their voluntary contribution account balances.

The following table sets forth the estimated annual benefits payable, assuming retirement at their normal retirement dates under the Pension Plan as currently in effect, to (i) the individuals named in the table under "Executive Compensation" and (ii) all executive officers of the Company as a group:

<u>Name of Individual or Number in Group</u>	<u>Estimated Annual Benefits</u>
Eddie Antar	\$ 3,072
Sam Antar	9,072(1)
Mitchell Antar	1,980
Morton Gindi	672
Sam E. Antar	—
Executive officers as a group (nine persons)	23,148

(1) Includes estimated annual benefits to be received by Rose Antar, the wife of Sam Antar.

For a discussion of the historical aggregate pension expense, see Note 5 of Notes to Consolidated Financial Statements.

CERTAIN TRANSACTIONS

Reorganization

In December 1983, all of the outstanding shares of Common Stock of Crazy Eddie, Inc., a New York corporation, were contributed to a newly organized Delaware corporation in exchange for 5,000 shares of its common stock. On September 13, 1984, prior to the consummation of the Initial Public Offering, the New York corporation was merged into the Delaware corporation, thereby changing the Company's corporate domicile to Delaware. In connection with the merger, the Company paid a stock dividend of 999 shares of Common Stock for each of the 5,000 shares of Common Stock outstanding, thereby effecting the equivalent of a 1,000-for-one stock split and increasing the number of shares of Common Stock outstanding immediately prior to the consummation of the Initial Public Offering to 5,000,000. A total of 1,700,000 shares of Common Stock were issued by the Company pursuant to the Initial Public Offering. See "Description of Capital Stock."

In 1980, the Company invested \$1,500,000 in White Rim Oil and Gas Associates, 1980-II (the "Partnership"), a Utah limited partnership formed for the purpose of engaging in oil and gas exploration and development. Of such amount, \$375,000 was paid in cash and \$1,125,000 was represented by note obligations to the Partnership due during the period from 1992 through 1995 that bear non-recourse simple interest at the rate of 7% per annum. Because the Company believed that its investment in the Partnership represented a tax advantaged investment that was inappropriate for a publicly-owned corporation, prior to the consummation of the Initial Public Offering, the Company contributed its investment in the Partnership, which had a net carrying value of \$140,000 at May 31, 1984, together with such note obligations and cash of \$500,000 (which amount represented the estimated discounted present value of such note obligations, assuming the repayment of such obligations is not deferred), to a newly formed subsidiary of the Company, C.E. Holdings, Inc. ("Newco"), the stock of which was then transferred to Eddie Antar and Sam Antar. Newco in turn (i) assumed the Company's obligation to make payment of the note obligations (totaling \$1,125,000) and (ii) indemnified the Company against any tax liabilities (including deficiencies, interest and penalties) that might be assessed against the Company if there were to be any disallowance on audit of the \$1,351,000 of tax deductions previously taken by the Company with respect to such oil and gas partnership. Eddie Antar and Sam Antar have guaranteed the performance of the obligation of Newco to indemnify the Company against any such tax liabilities. In February 1986, the Company received an assessment notice from the Internal Revenue Service pursuant to which deficiencies in the aggregate amount of \$461,526 (plus interest) were assessed against the Company as a result of the disallowance on audit of certain of the tax deductions previously taken by the Company with respect to its investment in the Partnership. As noted above, Newco has indemnified the Company against such tax liabilities, and it is anticipated that such liabilities will be paid by Newco on behalf of the Company directly to the Internal Revenue Service. See Note 1 of Notes to Consolidated Financial Statements.

In addition, also prior to the consummation of the Initial Public Offering, the Company transferred to Eddie Antar and Sam Antar its interest in the "Brewer Venture," another oil and gas investment, in consideration of their payment to the Company of \$5,000 (which amount represented the estimated current value of such investment as determined by an independent appraisal). The Company's contribution to this joint venture, which the Company also believed to be a tax advantaged investment that was inappropriate for a publicly-owned corporation, consisted of its interest in an oil and gas mining lease covering certain land in Oklahoma. The Company paid \$575,000 between 1980 and 1982 in connection with the acquisition and development of this property. Except as described in Note 1 of Notes to Consolidated Financial Statements, the Company does not believe that it now has, or that it may incur in the future, any liabilities in connection with this investment and, except as described therein, Eddie Antar and Sam Antar have agreed to indemnify the Company with respect to any such liabilities should they arise.

Other Transactions

Leases. The Company leases its Union, New Jersey store from Eddie Antar and Sam Antar. The lease expires on December 31, 1988 and provides for an annual rental of \$104,000 for the year ending May 31, 1986 with increases of \$10,000 per year thereafter. The Company leases its East 86th Street

store in New York City from the father-in-law of Sam E. Antar, who was elected Controller of the Company in June 1985. The lease expires on April 30, 1994 and provides for an annual rental of \$305,000 for the year ending April 30, 1987 with increases of \$10,000 per year thereafter. The Company believes that the terms of these leases are no less favorable to the Company than the terms of similar leases of other stores entered into by the Company in arm's-length transactions with unaffiliated parties. See "Business—Properties."

Benel. Benel Distributors, Ltd. ("Benel"), a New York corporation wholly-owned by Ben Kuszer, Eddie Antar's brother-in-law, and Mr. Kuszer's wife, sells pre-recorded audio and video cassettes and records in each Crazy Eddie store pursuant to certain license agreements in each case entered into between the wholly-owned subsidiary of the Company operating the Crazy Eddie store (the "Licensor") and a wholly-owned subsidiary of Benel operating the concession in such store (the "Licensee"). Each license agreement is on a month-to-month basis, and may be terminated by the Licensor upon ten days' notice to the Licensee. Each Licensee pays a fixed monthly fee, ranging from \$2,000 to \$7,000, for the use of its premises. Such fees aggregated \$347,000, \$382,000 and \$741,000 for the fiscal years ended May 31 1984, the nine months ended March 3, 1985 and the fiscal year ended March 2, 1986, respectively. In addition, pursuant to separate license agreements, each Licensor has agreed, subject to certain conditions, to permit its Licensee to use the marks "Crazy Eddie" and "Crazy Eddie Record and Tape Asylums," under which Benel operates its concessions.

In the prior years, the Company purchased audio and video tapes that were then sold to Benel. The Company terminated its sales to Benel (other than the consignment sale referred to below) on May 31, 1984, at which time Benel owed the Company \$2,590,612 in respect of sales and loans by the Company. Benel repaid this amount to the Company on October 1, 1984. The Company will not make any further loans to or guarantee any loans for Benel.

At May 31, 1984, the Company had on hand inventory intended for sale through Benel having a cost to the Company approximating \$1,200,000. Although the Company retained title to such inventory, it was consigned to Benel for retail sale. During the nine months ended March 3, 1985, Benel sold a portion of such inventory having a cost to the Company of \$1,018,611. Such amount was paid by Benel to the Company. Since March 3, 1985, the balance of such inventory has been sold and the Company has received payment for its cost.

The Company intends to lease to Benel approximately 35,000 square feet of space in its new corporate headquarters in Edison, New Jersey at a fair market rent.

The Company does not sell for its own account any products sold by Benel, and therefore does not compete with Benel or any of its subsidiaries. The Benel concessions in each Crazy Eddie store are allocated between 450 and 2,476 square feet of retail space. Under the license agreements, Benel has committed to expend a minimum amount each month for advertising utilizing the "Crazy Eddie" and "Crazy Eddie Record and Tape Asylums" marks. For its fiscal years ended April 30, 1984, 1985 and for the ten months ended March 2, 1986, Benel's gross advertising expenditures were \$593,666, \$803,582, and \$870,000, respectively, which amounts were substantially in excess of the minimum amounts required by the license agreements. The Company believes that its own operations have benefited from Benel's advertising, as well as from the customer traffic generated by the Benel concessions, and intends to offer Benel similar concessions in each of the Company's new stores.

Transactions with Other Related Companies. From time to time prior to May 31, 1984, the Company sold merchandise to and bought merchandise from, and made short-term loans for working capital purposes to, companies (other than Benel) controlled by Eddie Antar, Sam Antar or, in one instance, Ben Kuszer, Eddie Antar's brother-in-law (collectively, the "Other Related Companies"). The Other Related Companies include, among others, (i) Acousti-phase, Inc. ("Acousti-phase"), a New York corporation previously engaged in the manufacture of stereo speakers, (ii) Captain Video Enterprises, Inc. ("Captain Video"), a Florida corporation which, together with its subsidiaries, operates a chain of retail stores located in southeast Florida that are operated under the Captain Video name and engaged in the sale of home entertainment and consumer electronic products, (iii) Disc-O-Mat, Inc. ("Disc-O-Mat"), a New York corporation which, together with its subsidiaries, operates a chain of six retail stores located in New York City and New Jersey that sell pre-recorded cassettes and records, (iv) S&M Discount Center, Inc. ("S&M Discount"), a New Jersey corporation

which operates two stores located in Jersey City, New Jersey that sell home entertainment and consumer electronic products and (v) the University of St. Lucia School of Medicine, Ltd. (the "University"), a corporation chartered under the laws of St. Lucia which operated a medical school on the island of St. Lucia which has since closed, and Educators International, Inc., a New York corporation that was employed to provide recruiting and other services to the University. For the most part, the Company derived no benefit from any advances made to affiliated entities. The Company does not compete with Acousti-phase or Disc-O-Mat, and does not regard S&M Discount as a significant competitor. Because the Captain Video stores are located in a different geographic region than the Crazy Eddie stores, the Company does not regard Captain Video as a competitor. Stereo Village Inc., an unaffiliated entity, acquired Captain Video in June 1985. Eddie Antar does not devote a substantial amount of time to the business of any of the Other Related Companies, and does not intend to do so in the future.

For the three years ended May 31, 1984, the Company sold to, and purchased from, all of the Other Related Companies, including the companies referred to in the preceding paragraph, merchandise in the aggregate amounts of \$1,605,000 and \$1,539,000, respectively, and loaned on an interest-free basis to all of such companies an aggregate of \$4,105,000.

Because the Company did not regularly post its accounts on a monthly basis during the subject three-year period, it is not possible to determine at specific dates during the period the exact amount of loans then outstanding. At May 31, 1984, however, the Company was owed an aggregate of \$3,148,662 by the Other Related Companies, including certain open accounts. All amounts owed by the Other Related Companies to the Company upon the consummation of the Initial Public Offering were repaid in full at such time by Eddie Antar and Sam Antar out of their respective shares of the net proceeds of such offering. In exchange for such repayment, Eddie Antar and Sam Antar received an assignment of, and became subrogated to, the rights of the Company against the Other Related Companies. Since May 31, 1984, the Company has not sold to or purchased from, or made any loans to, any of the Other Related Companies, and the Company does not intend to do so in the future. See Note 9 of Notes to Consolidated Financial Statements.

Other Loans and Guaranties. Prior to the consummation of the Initial Public Offering, the Company frequently made loans on an interest-free basis to Eddie Antar, Sam Antar and members of their family to meet family needs. For the reasons stated above, the Company is not able to determine precisely the maximum amount outstanding at any time during the three years ended May 31, 1984 with respect to these loans. An aggregate of \$186,450 owed by Eddie Antar and Sam Antar to the Company was offset against compensation paid to such persons for fiscal 1984. At May 31, 1984, Eddie Antar and Sam Antar were indebted to the Company in the amount of \$50,000 and, in May 1984, the Company made an interest-free loan to Solomon E. Antar, Secretary and General Counsel of the Company, in the amount of \$237,500. These amounts were repaid upon consummation of the Initial Public Offering.

The Company will not make any additional loans or advances of any kind in the future to Eddie Antar, Sam Antar or members of their immediate families. In addition, the Company will not make loans to any other officer, except in the ordinary course of business, or otherwise with the approval of a disinterested majority of independent directors and, in the case of loans other than in the ordinary course of business, provided such loans are fully disclosed in subsequent reports to stockholders. The Company derived no benefit from loans to Eddie Antar and Sam Antar.

In April 1980, the Company loaned \$100,000 to a trust in which Eddie Antar and Sam Antar have a 50% beneficial interest. This loan, which was secured by a mortgage on certain property located in Florida, was for a term of five years at an interest rate of 18% per annum, and matured on April 1, 1985. At May 31, 1984, \$31,000 was owed to the Company on this mortgage, the repayment of which was guaranteed by Eddie Antar. This amount was repaid subsequent to the Initial Public Offering.

In September 1978, the Company guaranteed borrowings by Eddie Antar and Sam Antar in the amount of \$400,000 in connection with their purchase of property in Union, New Jersey which is leased to the Company. In May 1982, the Company guaranteed borrowings by Shoe Time, Inc., a corporation that is controlled by Sam Antar and that has filed a petition under the federal bankruptcy laws, in the amount of \$500,000, of which \$455,556 remained outstanding at May 31, 1984. The Company has been released from these obligations and, in the case of the loan to Shoe Time, Sam Antar substituted his

personal guaranty. The Company will not in the future guarantee the obligations of Eddie Antar, Sam Antar or members of their immediate family.

The Company has made loans to certain of its officers to enable them to exercise stock options. Each of these loans has a one-year term and bears interest at the prime rate. On September 20, 1985 and April 11, 1986, the Company loaned \$123,100 and \$98,800, respectively, to David Pardo. On January 31, 1986 the Company loaned \$84,718 to Morton Gindi. On June 13, 1986, the Company loaned \$125,430 to Solomon E. Antar. In addition, the Company loaned \$10,375 to David V. Panoff on April 7, 1986, which loan has since been repaid.

The Company will not engage in transactions with officers, directors, controlling persons and others affiliated with them unless such transactions are on terms no less favorable to the Company than could be obtained from unaffiliated third parties.

PRINCIPAL STOCKHOLDERS

The following table sets forth certain information regarding the beneficial ownership of the Company's Common Stock by (a) each person known by the Company to own beneficially more than 5% of the Company's Common Stock; (b) each of the Company's directors who own shares of the Company's Common Stock; and (c) all directors and officers of the Company as a group. Unless otherwise noted in the footnotes to the table, the persons named in the table have sole voting and investment power with respect to all shares of Common Stock shown as beneficially owned by them.

Beneficial Owner	Shares Owned	
	Number	Percentage
Eddie Antar(1)	2,428,110	15.6%
Citicorp(2)	886,910	5.7
Jundt/Capen Associates, Inc.(3)	778,800	5.0
Sam Antar	403,340	2.6
Mitchell Antar	30,500(4)	0.2
Eddy Antar	30,500(4)	0.2
James H. Scott, Jr.	1,000	—
Directors and officers as a group (11 persons)	3,005,950(5)	19.3

- (1) The business address of Eddie Antar, Chairman of the Board, President and Chief Executive Officer of the Company, is 2845 Coney Island Avenue, Brooklyn, New York.
- (2) As of March 31, 1986, as reported in Form 13F filed by Citicorp with the Securities and Exchange Commission on May 14, 1986. According to the Form, Citicorp has sole power to vote 179,110 of the shares included in the table, shared power to vote 3,000 of such shares and no power to vote 704,800 of such shares, and has shared investment power with respect to all of such shares. The business address of Citicorp is 399 Park Avenue, New York, New York 10043.
- (3) As of March 31, 1986, as reported in a Form 13F filed by Jundt/Capen Associates, Inc. ("Jundt/Capen") with the Securities and Exchange Commission on May 14, 1986. Jundt/Capen reports that it has sole power to vote 389,700 of the shares included in the table and no power to vote 389,100 of such shares, and that it has sole investment power with respect to all of such shares. The business address of Jundt/Capen is 1660 South Highway 100, Minneapolis, Minnesota 55416.
- (4) Includes (i) 20,500 shares issuable upon the exercise of currently exercisable options due to expire on September 20, 1994 and 10,000 shares issuable upon the exercise of currently exercisable options due to expire on October 7, 1995.
- (5) Includes 58,500 shares issuable upon the exercise of currently exercisable options due to expire on September 20, 1994 and 47,000 shares issuable upon the exercise of currently exercisable options due to expire on October 7, 1995. See footnote (4) above.

By virtue of his beneficial ownership of Common Stock and his position as an executive officer and director of the Company, Eddie Antar may be deemed to be a "parent" of the Company within the meaning of the rules and regulations of the Securities and Exchange Commission.

DESCRIPTION OF DEBENTURES

The Debentures offered hereby are to be issued under an indenture (the "Indenture") to be dated as of June 15, 1986 between the Company and RepublicBank Dallas, National Association (as "Trustee"). The statements under this caption are summaries and do not purport to be complete. The summaries make use of terms defined in the Indenture and are qualified in their entirety by reference to the Indenture, a copy of which is filed as an exhibit to the Registration Statement. Article and Section references appearing below are to the Indenture.

General

The Debentures will be limited to \$65,000,000 aggregate principal amount (subject to increase in the event of exercise of all or a portion of the Underwriters' over-allotment option), will be issued in denominations of \$1,000 and any integral multiple of \$1,000, in fully registered form only, will bear interest from June 15, 1986, at the rate of interest stated in their title and will mature on June 15, 2011. The Debentures will be subordinated to Senior Indebtedness of the Company as described below under "Subordination" and will not be secured by any lien. Interest will be payable semiannually on June 15 and December 15 (except that, in the case of Debentures called for redemption between the Regular Record Date and the next succeeding interest payment date, accrued interest will be paid to the redemption date) to the persons in whose names the Debentures are registered at the close of business on the Regular Record Date for such interest installment. (Article Two)

Conversion Rights

The Debentures will be convertible into Common Stock (except as described in the following paragraph) of the Company at any time on or prior to June 15, 2011 (unless a Debenture or a portion thereof shall have been called for redemption, in which case it will be convertible if duly surrendered on or before the date fixed for redemption in respect of such Debenture or portion thereof called for redemption) at the conversion price set forth on the cover page of this Prospectus, adjusted as described below. (Section 5.01) Notice of redemption will be given to holders of Debentures to be redeemed by first class mail at their last addresses on the Debenture registry. (Section 3.02)

In case of any consolidation or merger to which the Company is a party other than a transaction in which the Company is the continuing corporation (and which does not result in any reclassification or change in the outstanding shares of Common Stock), or in case of any sale or conveyance to another corporation of the property of the Company as an entirety or substantially as an entirety, or in case of any statutory exchange of securities with another corporation, there will be no adjustment of the conversion price, but the holder of each Debenture then outstanding will have the right thereafter to convert such Debenture into the kind and amount of securities, cash or other property which he would have owned or have been entitled to receive after such consolidation, merger, statutory exchange, sale or conveyance had such Debenture been converted immediately prior to the effective date of such consolidation, merger, statutory exchange, sale or conveyance. (Section 5.10) In the case of a cash merger of the Company with another corporation or any other cash transaction of the type mentioned above, the effect of these provisions would be that the conversion features of the Debentures would thereafter be limited to converting the Debentures at the conversion price in effect at such time into the same amount of cash per share that such holder would have received had such holder converted the Debentures into Common Stock of the Company immediately prior to the effective date of such cash merger or transaction. Depending upon the terms of such cash merger or transaction, the aggregate amount of cash so received on conversion could be more or less than the principal amount of the Debentures.

The conversion price is subject to adjustment upon certain events, including the issuance of Common Stock of the Company as a dividend or distribution on Common Stock; subdivisions, combinations or reclassifications of Common Stock; the issuance to holders of the Common Stock generally of certain rights or warrants (expiring within 45 days after the record date for determining

stockholders entitled to receive them) to subscribe for Common Stock at less than the then current market price (as defined); or the distribution to the holders of Common Stock generally of evidences of indebtedness, assets (excluding dividends in cash out of retained earnings) or rights or warrants to subscribe to securities of the Company other than those mentioned above. No adjustment of the conversion price will be required to be made in any case until cumulative adjustments amount to one percent or more of the conversion price. Fractional shares of Common Stock are not to be issued upon conversion. A person otherwise entitled to a fractional interest shall receive cash equal to the market value of such fractional interest. Under certain circumstances, a decrease in the conversion price of the Debentures may be considered as resulting in the distribution of a dividend to holders of the Debentures for Federal income tax purposes.

On conversion no adjustment for interest or dividends is to be made. A holder who surrenders a Debenture for conversion between the Regular Record Date for the payment of an installment of interest and the next interest payment date will receive interest on such interest payment date; however, any Debenture surrendered for conversion between the Regular Record Date and the next interest payment date must be accompanied by payment of an amount equal to the interest to be received in respect of any portion of the Debenture being converted. (Section 5.02)

The Company has covenanted under the Indenture, at all times, to reserve and keep available out of the aggregate of its authorized but unissued Common Stock, for the purpose of effecting conversions of Debentures, the full number of shares of Common Stock deliverable upon the conversion of all outstanding Debentures.

Subordination

The Debentures are subordinated and subject in right of payment to the prior payment in full of the principal of and premium, if any, and interest on all Senior Indebtedness. (Article Four) "Senior Indebtedness" is defined to mean the principal of (and premium, if any) and interest on (a) all indebtedness of the Company (including indebtedness of others guaranteed by the Company) other than the Debentures, whether outstanding on the date of the Indenture or thereafter created, incurred or assumed, which is (i) for money borrowed or (ii) evidenced by a note or similar instrument given in connection with the acquisition of any businesses, (b) obligations of the Company as lessee under leases required to be capitalized on the balance sheet of the lessee under generally accepted accounting principles or leases of property or assets made as part of any sale and leaseback transactions to which the Company is a party or (c) amendments, renewals, extensions, modifications and refundings of any such indebtedness or obligations unless in any case in the instrument creating or evidencing any such indebtedness or obligations or pursuant to which the same is outstanding it is provided that such indebtedness is subordinated in right of payment to all indebtedness of the Company or is not senior in right of payment to the Debentures. (Section 1.01)

In the event of any payment or distribution of assets of the Company upon any dissolution or winding up or partial liquidation or reorganization of the Company (whether voluntary or involuntary or in bankruptcy, insolvency or receivership proceedings or otherwise), all principal of and premium, if any, and interest due upon all Senior Indebtedness shall first be paid in full before the holders of the Debentures are entitled to receive any payments in respect of the Debentures. No payments on account of principal, premium, if any, sinking funds or interest on the Debentures shall be made, nor shall any Debentures be purchased, if there is a default on Senior Indebtedness or under any agreement pursuant to which Senior Indebtedness is issued.

By reason of the Debenture's subordination, in the event of insolvency, general creditors of the Company who are not holders of Senior Indebtedness may recover less, ratably, than holders of Senior Indebtedness, and may recover more, ratably, than the holders of the Debentures or other subordinated indebtedness.

The Company is not restricted by the Indenture from incurring, assuming, guaranteeing or otherwise becoming liable on any Senior Indebtedness. The amount of Senior Indebtedness outstanding as of June 1, 1986, was approximately \$9,900,000.

Redemptions

Optional Redemption. The Debentures are redeemable at the Company's option at any time, as a whole or from time to time in part, upon mailing a notice of redemption not less than 30 nor more than 60 days prior to the date fixed for such redemption to the debentureholders at their last registered addresses at a price equal to _____ % of the principal amount, together with interest accrued to the redemption date, if redeemed prior to June 15, 1987 and at the following redemption prices (expressed in percentages of the principal amount), in each case together with accrued interest to the date fixed for redemption, if redeemed during the twelve months' period beginning June 15 of the years indicated below. The Debentures may not be redeemed, however, prior to June 15, 1988 unless the reported closing price of the Common Stock on the principal trading market was at least 140% of the effective conversion price on any 20 trading days within a period of 30 successive trading days ending within 15 business days prior to the date of notice of redemption. (Section 3.01)

If redeemed during the twelve months' period beginning June 15:

<u>Year</u>	<u>Percentage</u>	<u>Year</u>	<u>Percentage</u>
1987	%	1992	%
1988		1993	
1989		1994	
1990		1995	
1991		1996-2010	100.000

Sinking Fund. The Indenture provides that the Company will pay to the Trustee as a required sinking fund a sum sufficient to redeem, on June 15 in each of the years 1997 through 2010, 5% of the original aggregate principal amount of Debentures together with earned interest thereon. (Section 3.03) The sinking fund payments are calculated to retire 70% of the Debentures prior to maturity. (Section 3.01)

The Company may elect to credit against any required sinking fund payment the principal amount of any Debentures (a) redeemed at the election of the Company, (b) surrendered for conversion or (c) acquired by the Company other than by redemption or upon conversion and not previously used for the purpose of such credit. (Section 3.03)

Events of Default, Notice and Waiver

The Indenture provides that, if an Event of Default specified therein shall have occurred and be continuing, either the Trustee or the holders of not less than 25% in principal amount of the Debentures then outstanding may declare the principal of all such Debentures due and payable. (Article Eight)

Events of Default are defined as: default for 30 days in payment of any interest instalment; default in payment of principal or premium, if any, or in the making of any sinking fund payment, when due, whether or not such payments are prohibited by the subordination provisions of the Indenture; and default under any other bond, debenture, note or other evidence of money borrowed, or under any indenture or other instrument under which the Company may have outstanding any indebtedness, which default results in acceleration of such indebtedness in an aggregate principal amount of \$5,000,000 or more by the holders thereof, without such indebtedness having been discharged, or such acceleration having been rescinded or annulled, within a period of 30 days after there shall have been given notice to the Company and the Trustee by the holders of at least 25% in principal amount of the outstanding Debentures, provided that after a declaration of acceleration with respect to the Debentures has been made, but before a judgment based on acceleration has been obtained, the holders of a majority in principal amount of the outstanding Debentures may by written notice rescind and annul such acceleration; default for 90 days after notice to the Company by the Trustee or by the holders of not less than 25% in principal amount of the outstanding Debentures in performance of any other covenant or agreement in the Indenture; and certain events of bankruptcy, insolvency and reorganization.

The Indenture provides that the Trustee shall, within 90 days after the occurrence of a default (not including any grace period allowed), give to the holders of Debentures as their names and addresses

appear on the registration books notice of all uncured defaults known to it; provided that, except in the case of default in the payment of principal or premium, if any, or interest on any of the Debentures or the making of any sinking fund payment, the Trustee shall be protected in withholding such notice if it in good faith determines that the withholding of such notice is in the interest of the debentureholders.

The Indenture contains a provision entitling the Trustee, subject to the duty of the Trustee during a default to act with the required standard of care, to be indemnified by the debentureholders before proceeding to exercise any right or power under the Indenture at the request of such debentureholders. (Section 9.02) The Indenture provides that the holders of a majority in principal amount of the outstanding Debentures may direct the time, method and place of conducting any proceeding for any remedy available to the Trustee, or exercising any trust or power conferred on the Trustee. (Section 8.07)

The Indenture includes a covenant that the Company will file annually with the Trustee a certificate of no default or specifying any default that exists. (Section 6.04)

In certain cases, the holders of a majority in principal amount of the outstanding Debentures may on behalf of the holders of all Debentures waive any past default or Event of Default except, unless theretofore cured, a default in payment of the principal and premium, if any, or interest on any of the Debentures, or any sinking fund payment with respect thereto. (Section 8.07)

Modification of the Indenture and Waiver

The Indenture contains provisions permitting the Company and the Trustee, with the consent of the holders of not less than a majority in principal amount of the outstanding Debentures, to execute supplemental indentures adding any provisions to or changing or eliminating any of the provisions of the Indenture or modifying the rights of the holders of Debentures, except that no such supplemental indenture may (a) extend the fixed maturity of any Debentures, or reduce the principal amount thereof or any premium thereon, or reduce the rate or extend the time of payment of interest thereon, or modify the provisions of the Indenture with respect to the subordination of the Debentures in a manner adverse to the debentureholders, or impair the right to convert the Debentures, without the consent of the holders of affected Debentures, or (b) reduce the aforesaid percentage of Debentures, the consent of the holders of which is required for any such supplemental indenture. (Section 12.02) The holders of not less than a majority in principal amount of the outstanding Debentures may waive any existing default other than a default in the payment of principal of, interest on or sinking fund payment with respect to the Debentures. (Section 8.07)

Concerning the Trustee

RepublicBank Dallas, National Association will be the Trustee under the Indenture. All payments of principal of, premium, if any, and interest on, and registration, transfer, exchange, conversion, authentication, delivery (including authentication and delivery on original issuance of the Debentures) and redemption of, the Debentures will initially be effected by the Trustee, as Authenticating Agent, Paying Agent, and Registrar. The Trustee and the Company have recently entered into a \$50,000,000 short-term credit and letter of credit facility. See "Management's Discussion and Analysis of Financial Condition and Results of Operations."

Reports to Debentureholders

The Company intends to furnish to holders of the Debentures all quarterly and annual reports that it furnishes to holders of its Common Stock.

DESCRIPTION OF CAPITAL STOCK

The authorized capital stock of the Company consists of 50,000,000 shares of Common Stock, par value \$.01 per share, and 5,000,000 shares of Preferred Stock, par value \$1.00 per share. As of May 28, 1986, 15,572,786 shares of Common Stock, and no shares of Preferred Stock were outstanding.

Common Stock

Holders of shares of Common Stock are entitled to one vote per share in all matters to be voted on by stockholders, and are entitled to dividends and other distributions as and when declared by the Board of Directors out of assets legally available therefor. See "Price Range of Common Stock and Dividend Policy." Upon the liquidation, dissolution or winding up of the Company, the holders of Common Stock are entitled to share pro rata in the distribution of all of the Company's assets, subject to existing claims of creditors and the rights of the holders of any then outstanding Preferred Stock. The holders of Common Stock have no preemptive rights to purchase shares of stock of the Company, and they are not entitled to the benefits of any sinking fund provision. Shares of Common Stock of the Company are not subject to any redemption provisions, and are not convertible into any other security or other property of the Company. All outstanding shares of Common Stock are fully paid and non-assessable.

Preferred Stock

The Board of Directors is empowered under the Company's Certificate of Incorporation and without further stockholder action to divide any or all shares of the Preferred Stock into series and to fix and determine the relative rights and preferences of the shares of any series so established. The issuance of Preferred Stock by the Board of Directors could affect the rights of holders of shares of Common Stock. For example, issuance of the Preferred Stock could result in a class of securities outstanding that will have certain preferences with respect to dividends and in liquidation over the Common Stock, and may enjoy certain voting rights, contingent or otherwise, in addition to that of the Common Stock, and could result in the dilution of the voting rights, net income per share and net book value of the Common Stock. Shares of Preferred Stock issued by the Board of Directors could be utilized, under certain circumstances, as a method of preventing a takeover of the Company. As of the date of this Prospectus, the Board of Directors has not authorized any series of Preferred Stock, and there are no agreements or understandings for the issuance of any shares of Preferred Stock. However, the Board of Directors may consider the issuance of shares of Preferred Stock to the Company's stockholders, or the adoption of other anti-takeover measures, prior to the Company's 1986 Annual Meeting of Stockholders.

Transfer Agent and Registrar

The transfer agent and registrar for the Company's Common Stock is Bank Leumi Trust Company of New York.

UNDERWRITING

The Underwriters named below have severally agreed, subject to certain conditions, to purchase from the Company the principal amount of Debentures set forth opposite their respective names:

<u>Underwriter</u>	<u>Principal Amount</u>
Wertheim & Co., Inc.	\$21,668,000
Bear, Stearns & Co. Inc.	21,666,000
Salomon Brothers Inc.	21,666,000
Total	<u>\$65,000,000</u>

The Underwriting Agreement provides that the several Underwriters are obligated to purchase all the Debentures offered hereby, if any are purchased. Wertheim & Co., Inc., Bear, Stearns & Co. Inc. and Salomon Brothers Inc (the "Underwriters"), have advised the Company that the Underwriters propose to offer the Debentures to the public initially at the offering price set forth on the cover page of this Prospectus; that the Underwriters propose initially to allow a concession of not in excess of % of the principal amount of the Debentures to certain dealers, including Underwriters; that the Underwriters and such dealers may initially allow a discount of not in excess of % of the principal amount of the Debentures to other dealers; and that the public offering price and the concession and discount to dealers may be changed by the Underwriters after the initial public offering.

The Company has granted to the Underwriters an option, expiring at the close of business on the 30th day after the date of this Prospectus, to purchase up to \$7,000,000 principal amount of additional Debentures at the Price to Public less Underwriting Discounts and Commissions, all as set forth on the cover page of this Prospectus. The Underwriters may exercise such option solely for the purpose of covering over-allotments, if any, made in the sale of the Debentures offered hereby. To the extent such option to purchase is exercised, each Underwriter will become obligated, subject to certain conditions, to purchase a principal amount of Debentures proportional to such Underwriter's initial commitment.

The Company has agreed that it will not sell or otherwise dispose of any Common Stock for a period of 90 days after the date of this Prospectus without prior written consent of the Underwriters except for the sale or issuance by the Company of shares pursuant to the exercise of employee stock options or pursuant to the exercise of warrants that the Prospectus indicates are outstanding.

The Company has agreed to indemnify the Underwriters against certain liabilities, including certain liabilities under the Securities Act of 1933.

CERTAIN LEGAL MATTERS

The validity of the Debentures offered hereby will be passed upon for the Company by Paul, Weiss, Rifkind, Wharton & Garrison, 345 Park Avenue, New York, New York 10154, and for the Underwriters by Reavis & McGrath, 345 Park Avenue, New York, New York 10154.

EXPERTS

The consolidated financial statements included in this Prospectus and the financial statement schedules included in the Registration Statement of which this Prospectus is a part have been examined by KMG Main Hurdman, independent accountants, as of and for the year ended May 31, 1984, the nine months ended March 3, 1985 and the year ended March 2, 1986, and have been so included in reliance on their respective reports given on their authority as experts in auditing and accounting. The selected consolidated financial data appearing under the caption "Selected Consolidated Financial Data" as of and for the years ended May 31, 1983 and 1984, the nine months ended March 3, 1985 and the year ended March 2, 1986 have been derived from consolidated financial statements of the Company examined by KMG Main Hurdman, independent accountants, and, as of and for the year ended May 31, 1982 has been derived from consolidated financial statements of the Company examined by J. Liebman & Co. (formerly Penn and Horowitz), independent accountants, and have been so included in reliance on their respective reports given on their authority as experts in auditing and accounting.

CRAZY EDDIE, INC. AND SUBSIDIARIES
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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

The Board of Directors
Crazy Eddie, Inc.

We have examined the consolidated balance sheet of Crazy Eddie, Inc. and subsidiaries as of March 2, 1986 and March 3, 1985, and the related consolidated statements of operations, changes in stockholders' equity and changes in financial position for the year ended March 2, 1986, the nine months ended March 3, 1985 and the year ended May 31, 1984. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, such financial statements present fairly the financial position of Crazy Eddie, Inc. and subsidiaries at March 2, 1986 and March 3, 1985, and the results of their operations and the changes in their financial position for the year ended March 2, 1986, the nine months ended March 3, 1985 and the year ended May 31, 1984, in conformity with generally accepted accounting principles applied on a consistent basis.

We have also examined the consolidated financial statements for the year ended May 31, 1983 in accordance with generally accepted auditing standards. In our opinion, the information set forth in "Selected Consolidated Financial Data" as of and for the year ended March 2, 1986, the nine months ended March 3, 1985 and the years ended May 31, 1984 and 1983, appearing on page 8 of this Prospectus, is fairly stated in all material respects in relation to the consolidated financial statements from which it has been derived.

KMG MAIN HURDMAN

New York, New York
May 1, 1986

CRAZY EDDIE, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET

	March 2, 1986	March 3, 1985
	(In Thousands)	
ASSETS		
Current assets:		
Cash	\$ 13,296	\$ 7,216
Short-term investments	26,840	15,057
Due from American Express Co.	2,246	1,875
Merchandise inventories	59,864	26,543
Prepaid expenses and other current assets	2,363	1,510
Total current assets	104,609	52,201
Restricted cash	3,356	7,058
Property, plant and equipment, less accumulated depreciation and amortiza- tion of \$2,922,000 and \$1,877,000	7,172	3,696
Construction in process	6,253	1,154
Other assets	5,560	1,419
	<u>\$126,950</u>	<u>\$65,528</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current maturities of long-term debt	\$ 2,254	\$ 423
Accounts payable	51,723	23,078
Unearned service contract revenue	3,696	1,173
Accrued liabilities:		
Income taxes	11,071	6,020
Compensation and payroll taxes	2,296	574
Sales tax payable	2,035	1,201
Pension	800	600
Other	924	338
Total current liabilities	74,799	33,407
Long-term debt, less current maturities	7,701	7,625
Unearned service contract revenue	1,829	635
Commitments and contingencies		
Stockholders' equity:		
Preferred stock—par value \$1.00 per share; authorized 5,000,000 shares, none issued	—	—
Common stock—par value \$.01 per share; authorized 50,000,000 shares, outstanding 14,005,421 and 13,400,000 shares, respectively	140	134
Additional paid-in capital	17,808	12,298
Retained earnings	24,673	11,429
Total stockholders' equity	42,621	23,861
	<u>\$126,950</u>	<u>\$65,528</u>

The accompanying notes are an integral part of these financial statements.

CRAZY EDDIE, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF OPERATIONS

	Year Ended March 2, 1986	Nine Months Ended March 3, 1985	Year Ended May 31, 1984
	(In Thousands, Except Per Share Amounts)		
Net sales	\$262,268	\$136,319	\$137,285
Cost of goods sold	<u>194,371</u>	<u>103,421</u>	<u>106,934</u>
Gross profit	67,897	32,898	30,351
Selling, general and administrative expense	<u>42,975</u>	<u>20,508</u>	<u>22,560</u>
	24,922	12,390	7,791
Other income	3,210	1,211	706
Interest expense	<u>(820)</u>	<u>(438)</u>	<u>(522)</u>
Income before pension contribution and income taxes	27,312	13,163	7,975
Pension contribution	<u>800</u>	<u>600</u>	
Income before income taxes	26,512	12,563	7,975
Income taxes	<u>13,268</u>	<u>6,734</u>	<u>4,202</u>
Net income	<u>\$ 13,244</u>	<u>\$ 5,829</u>	<u>\$ 3,773</u>
Earnings per share	<u>\$.96</u>	<u>\$.48</u>	<u>\$.37</u>
Weighted average number of shares outstanding	<u>13,832</u>	<u>12,106</u>	<u>10,000</u>

The accompanying notes are an integral part of these financial statements.

CRAZY EDDIE, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

Year Ended March 2, 1986,
Nine Months Ended March 3, 1985 and Year Ended May 31, 1984

	Common Stock Number of shares	Par Value	Additional Paid-in Capital (In thousands)	Retained Earnings	Total
Balance, June 1, 1983	5,000	\$ 50	\$ 574	\$ 2,327	\$ 2,951
Net income				3,773	3,773
Effect of deemed dividend				(500)	(500)
Stock split effected in the form of a dividend ..	5,000	50	(50)		
Balance, May 31, 1984	10,000	100	524	5,600	6,224
Net income				5,829	5,829
Issuance of 3,400,000 shares (Net of issuance costs)	3,400	34	11,774		11,808
Balance, March 3, 1985	13,400	134	12,298	11,429	23,861
Net income				13,244	13,244
Issuance of 605,421 shares (net of issuance costs and credit of approximately \$725,000)	605	6	5,510		5,516
Balance, March 2, 1986	14,005	\$140	\$17,808	\$24,673	\$42,621

The accompanying notes are an integral part of these financial statements.

CRAZY EDDIE, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

	Year Ended March 2, 1986	Nine Months Ended March 3, 1985 (In Thousands)	Year Ended May 31, 1984
Working capital provided from:			
Net income	\$13,244	\$ 5,829	\$ 3,773
Add charges not affecting working capital:			
Depreciation and amortization	1,044	417	410
Loss on disposal equipment	506	8	29
Working capital provided from operations	14,794	6,254	4,212
Reduction in advances to affiliates		7,140	4,639
Increase in unearned service contract revenue	1,194	309	97
Issuance of common stock—net	5,516	11,809	
Decrease in restricted cash	3,702		
Insurance proceeds			14
Increase in long-term debt	700	8,236	
Total working capital provided	<u>25,906</u>	<u>33,748</u>	<u>8,962</u>
Working capital used for:			
Increase in restricted cash		7,058	
Deemed dividend (Note 1)			500
Advances and sales to affiliates, net		1,401	7,494
Reduction in long-term debt	624	658	24
Acquisition of property, plant and equipment	4,986	2,277	470
Construction in process	5,099	1,154	
Increase in other assets	4,181	270	104
Total working capital used	<u>14,890</u>	<u>12,818</u>	<u>8,592</u>
Increase in working capital	<u>\$11,016</u>	<u>\$20,930</u>	<u>\$ 370</u>
Changes in working capital consisted of:			
Increase (decrease) in current assets:			
Cash	\$ 6,080	\$ 5,840	(\$ 974)
Short-term investments	11,783	15,057	
Due from American Express Co.	371	879	162
Merchandise inventories	33,321	3,200	8,039
Prepaid expenses and other current assets	853	(612)	1,660
	<u>52,408</u>	<u>24,364</u>	<u>8,887</u>
Increase (decrease) in current liabilities:			
Loans payable—officers and other			(1,968)
Current maturities of long-term debt	1,831	(2,601)	2,895
Accounts payable	28,645	2,971	6,108
Unearned service contract revenue	2,523	410	114
Accrued liabilities	8,393	2,654	1,368
	<u>41,392</u>	<u>3,434</u>	<u>8,517</u>
Increase in working capital	<u>\$11,016</u>	<u>\$20,930</u>	<u>\$ 370</u>

The accompanying notes are an integral part of these financial statements.

CRAZY EDDIE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tables Included in the Accompanying Footnotes are in Thousands Except for Per Share Data)

Note 1—Reorganization

In December 1983, the stockholders of Crazy Eddie, Inc., a New York corporation, contributed all of the outstanding shares of common stock of Crazy Eddie, Inc. to a newly organized Delaware corporation in exchange for 5,000 shares of its common stock. During September 1984, the New York corporation was merged into the new Delaware corporation (the "Company"). In connection with the merger, the Company declared a stock dividend of 999 shares of common stock for each of the 5,000 shares of common stock outstanding, which increased the number of outstanding shares of common stock to 5,000,000 shares. During September 1984, the Company sold to the public 1,700,000 shares of common stock (including 300,000 shares pursuant to an over-allotment option granted to the underwriters) at a price of \$8 per share.

In September 1984, the Company contributed an investment in an oil and gas limited partnership (the "Partnership") with a net carrying value of \$140,000 at May 31, 1984, together with note obligations of \$1,125,000 and cash of approximately \$500,000 (which amount represented the estimated discounted present value of such note obligations), to a newly formed subsidiary of the Company, C.E. Holdings, Inc. ("Newco"), the stock of which was then transferred to Eddie Antar and Sam Antar. The cash transfer of approximately \$500,000 has been accounted for as a deemed dividend in the accompanying consolidated financial statements. In addition, the Company will recognize taxable income of approximately \$625,000 (which represents the excess of the \$1,125,000 face amount of the note obligation over the \$500,000 cash transfer) in connection with such contribution and believes that the tax payable with respect to such taxable income will approximate \$200,000. Such amount has been provided for in the accompanying financial statements. The Company has received an assessment notice from the Internal Revenue Service pursuant to which deficiencies in the aggregate amount of \$461,526 (plus interest) were assessed against the Company as a result of the disallowance on audit of certain of the tax deductions previously taken by the Company with respect to its investment in the Partnership. Newco has indemnified the Company against such tax liability, and Eddie Antar and Sam Antar have guaranteed the performance of Newco's indemnification obligation.

Also during September 1984, the Company transferred to Eddie Antar and Sam Antar another oil and gas investment in consideration of the payment by them to the Company of \$5,000, which amount represented the estimated current value of such investment as determined by an independent appraisal. Eddie Antar and Sam Antar have indemnified the Company with respect to any liabilities in connection with this investment, other than with respect to the deduction of approximately \$270,000 (which amount represents the Company's allocable share of the losses generated by this investment) taken by the Company during the year ended May 31, 1982 in respect of such investment.

The foregoing transactions have been accounted for in a manner similar to a pooling of interests. Accordingly, the financial statements for all periods presented have been restated to retroactively reflect the reorganization and stock dividend.

Note 2—Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries (collectively referred to as Crazy Eddie, Inc. or the Company), all of which are wholly-owned.

Inventories

Merchandise inventories are stated at the lower of cost, using the first-in, first-out (FIFO) method, or market. Purchase discounts and trade allowances are recognized when received.

CRAZY EDDIE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Tables Included in the Accompanying Footnotes are in Thousands Except for Per Share Data)

Note 2—Summary of Significant Accounting Policies (Continued)

In accordance with industry practice, a substantial portion of the merchandise inventory has been purchased from suppliers under credit terms which grant the creditor a security interest in the inventory through the use of trust receipts.

Property, Plant and Equipment

Property, plant and equipment are carried at cost. Depreciation and amortization are computed using the straight-line method, based on the estimated useful lives of the assets. The rates used are as follows:

Building	5%
• Furniture and fixtures including capital- ized equipment leases and ware- house equipment	10%—20%
Automobiles and trucks	33⅓%
Leasehold improvements	Lesser of life of lease or useful life of improvement

Pensions

The Company funds currently the costs of its noncontributory pension plans, which cover eligible employees.

Unearned Service Contract Revenue

Payments received from customers for service contracts are deferred and amortized to income over the terms of the respective contracts, which generally do not exceed five years. Service costs relating to the service contracts are charged to operations as incurred.

Income Taxes

The Company files a consolidated federal income tax return with its subsidiaries.

Investment tax credits are accounted for as a reduction of income tax expense in the year in which such credits are allowable for income tax purposes. Deferred income taxes are provided for timing differences between financial and tax reporting primarily with respect to the reporting of unearned service contract revenue and deferred compensation in connection with the granting of nonqualified stock options.

Pre-opening Costs

Costs incurred in connection with the opening of new stores are expensed as incurred.

Earnings Per Share

Earnings per share were computed by dividing net income by the weighted average number of shares of outstanding common stock, after giving retroactive effect to the two for one stock split effected in the form of a dividend approved by the stockholders on July 16, 1985.

CRAZY EDDIE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Tables Included in the Accompanying Footnotes are in Thousands Except for Per Share Data)

Note 3—Property, Plant and Equipment

	March 2, 1986	March 3, 1985
Land	\$ 925	\$ 715
Building	765	
Office, warehouse and other equipment	2,650	1,431
Furniture and fixtures	1,556	759
Leasehold improvements	4,198	2,668
	<u>10,094</u>	<u>5,573</u>
Less accumulated depreciation and amortization	2,922	1,877
	<u>\$ 7,172</u>	<u>\$3,696</u>

Note 4—Taxes

Income tax expense consists of:

	Year Ended March 2, 1986	Nine Months Ended March 3, 1985	Year Ended May 31, 1984
Current:			
Federal	\$ 12,665	\$ 5,555	\$ 3,287
State and local	4,125	1,635	915
Deferred:	(3,522)	(456)	
	<u>\$ 13,268</u>	<u>\$ 6,734</u>	<u>\$ 4,202</u>

Reconciliations between actual tax expense and the amount computed by applying the statutory U.S. federal income tax rate are as follows:

	Year Ended March 2, 1986		Nine Months Ended March 3, 1985		Year Ended May 31, 1984	
	Amount	Percentage of Pre-Tax Earnings	Amount	Percentage of Pre-Tax Earnings	Amount	Percentage of Pre-Tax Earnings
Computed expected tax expense	\$12,196	46.0%	\$5,779	46.0%	\$3,669	46.0%
State and local taxes, net of federal income tax benefit	2,228	8.4	883	7.0	494	6.2
Investment and job tax credits	(300)	(1.2)	(75)	(.6)	(15)	(.2)
Reversal of tax reserves no longer required	(725)	(2.7)				
Other	(131)	(.5)	147	1.2	54	.6
	<u>\$13,268</u>	<u>50.0%</u>	<u>\$6,734</u>	<u>53.6%</u>	<u>\$4,202</u>	<u>52.6%</u>

Note 5—Pension Plans

Prior to May 31, 1984, the Company maintained a money purchase pension plan covering substantially all employees. Pursuant to the plan, the Company contributed a specified percentage (25%) of covered compensation to the plan for eligible employees (as defined in the plan) and a profit sharing plan, as described below.

On May 17, 1984, the Board of Directors adopted a resolution terminating the money purchase pension plan effective May 31, 1984. Such termination resulted in all participants becoming fully vested in their account balances to the extent the contributions made to their accounts did not exceed the

CRAZY EDDIE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued) (Tables Included in the Accompanying Footnotes are in Thousands Except for Per Share Data)

Note 5—Pension Plans (Continued)

maximum amount allowable under the plan. The Board of Directors also authorized the adoption of a new profit sharing plan effective June 1, 1984. Pursuant to the profit sharing plan, the Company will make annual contributions, out of its current or accumulated earnings or profits, up to a maximum of 15% of covered compensation, as defined in such plan, for all employees who meet certain eligibility requirements.

The aggregate pension expense for the year ended March 2, 1986 and the nine months ended March 3, 1985 was \$800,000 and \$600,000, respectively.

The Company was required to make a contribution to the money purchase pension plan for the fiscal year ended May 31, 1984 because required contributions were offset by employee forfeitures in the amount of approximately \$2,000,000 which occurred during the years 1980 through 1983. As a result of the funding status of the defined benefit pension plan, the Company was not required to make any pension contribution to that plan for the fiscal year ended May 31, 1984. Accordingly, no provision for pension expense was required in the accompanying financial statements for the year ended May 31, 1984.

Note 6—Leases and Other Commitments

Rent expense (including amounts paid in respect of maintenance, real estate taxes and other charges) for the year ended March 2, 1986 amounted to \$4,554,000, for the nine months ended March 3, 1985 amounted to \$1,652,000, and for the year ended May 31, 1984 amounted to \$1,857,000.

At March 2, 1986, the Company was obligated under leases with initial terms of more than one year covering certain real property. The aggregate minimum fixed rentals required under these leases (exclusive of renewal options) are as follows:

Year Ending March 2,	Aggregate Minimum Rental Commitment
1987	\$ 5,505
1988	5,681
1989	5,686
1990	5,814
1991	5,685
Thereafter through 2000	50,122
	<u>\$78,493</u>

Rent expense included \$185,000 for the year ended March 2, 1986, \$132,000 for the nine months ended March 3, 1985 and \$363,000 for the year ended May 31, 1984 for rentals paid to corporations controlled by Eddie Antar and Sam Antar or a corporation wholly owned by them.

At March 2, 1986, letters of credit approximating \$4,500,000 were outstanding.

Pursuant to certain license agreements, the Company subleases the record departments at all of its store locations to a corporation (Benel Distributors, Ltd.) wholly owned by Ben Kuszer, the brother-in-law of Eddie Antar, and Mr. Kuszer's wife. Other income includes \$741,000 for the year ended March 2, 1986, \$382,000 for the nine months ended March 3, 1985 and \$347,000 for the year ended May 31, 1984 in connection with these agreements.

CRAZY EDDIE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Tables Included in the Accompanying Footnotes are in Thousands Except for Per Share Data)

Note 7—Long-Term Debt

Long-term debt consists of the following:

	March 2, 1986	March 3, 1985
Series A Economic Development Bonds, payable in quarterly installments of \$51,667 beginning January 1, 1986(a)	\$6,148	\$6,200
Series B Economic Development Bonds, payable in monthly installments of \$19,048 beginning August 1, 1985(a)	1,448	1,600
Notes payable in connection with purchase of lease rights, payable in monthly installments of \$10,000 decreasing to \$6,500, commencing December 1, 1985	660	
Other	1,699	248
	9,955	8,048
Less current maturities of long-term debt	2,254	423
	<u>\$7,701</u>	<u>\$7,625</u>

- (a) On April 11, 1984, the Company entered into agreements to purchase approximately 11 acres of land in Edison, New Jersey and to have a builder construct the Company's new corporate headquarters on such land. The agreements were conditioned, among other things, upon the Company receiving from the New Jersey Economic Development Authority (the "Authority") approval for the issuance of economic development bonds to finance such acquisition and construction as well as certain related costs.

On December 21, 1984, the Company borrowed from the Authority the aggregate amount of \$7,800,000 in order to finance the acquisition of the land, the construction of the new facility and certain related machinery and equipment. The proceeds for such loan were provided pursuant to the issuance by the Authority of \$6,200,000 aggregate principal amount of its Series A Economic Development Bonds (Crazy Eddie, Inc.—1984 Project) (the "Series A Bonds") and \$1,600,000 aggregate principal amount of its Series B Economic Development Bonds (Crazy Eddie, Inc.—1984 Project) (the "Series B Bonds" and, together with the Series A Bonds, the "Bonds"). Pursuant to a loan agreement between the Authority and the Company, the Company is obligated to make principal and interest payments in respect of the loan in amounts sufficient to pay the amounts of principal and interest due from time to time on the Bonds. The Bonds bear interest at a rate equal to 75% of the rate of interest announced from time to time by Midlantic National Bank as its prime rate, but such rate may in no event exceed 14% or be less than 7½% per annum. Interest on the Bonds is payable monthly beginning January 1, 1985.

As security for repayment of the Bonds and the performance by the Company of its obligations under the loan agreement with the Authority, the Company has granted to the Authority a first mortgage lien on the new facility and a security interest in, among other things, all leases that are entered into by the Company with any tenant of the facility (including all rents payable to the Company thereunder).

Restricted cash represents monies reserved for the construction of the new corporate warehouse.

CRAZY EDDIE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued) (Tables Included in the Accompanying Footnotes are in Thousands Except for Per Share Data)

Note 7—Long-Term Debt (Continued)

Aggregate annual maturities of the long-term debt outstanding at March 2, 1986 for each of the next five fiscal years are as follows:

Year Ending March 2,	Aggregate Annual Maturity
1987.....	\$2,254
1988.....	621
1989.....	566
1990.....	513
1991.....	513

Note 8—Stock Option Plan

On August 28, 1984, the Company adopted the 1984 Stock Option Plan, which provides for the issuance of nonqualified and incentive stock options. The Company has reserved 500,000 shares of common stock for issuance to key employees under the plan.

Changes in the Stock Option Plan were as follows:

	Number of Shares		
	Authorized	Granted	Available
Balance, August 28, 1984	500		500
Granted	—	264	(264)
Balance, March 3, 1985	500	264	236
Granted	—	211	(211)
Exercised	(117)	(117)	—
Balance, March 2, 1986	<u>383</u>	<u>358</u>	<u>25</u>

The exercise price of any incentive stock option shall not be less than the fair market value of the shares subject to the option on the date of grant. The exercise price of any nonqualified stock option shall not be less than 85% of the fair market value of the shares subject to the option on the date of grant. The term of each option and the manner in which it may be exercised will be determined by a Committee of the Board of Directors, subject to the requirement that no option may be exercisable more than 10 years after the date of grant.

During the year ended March 2, 1986, 22,000 stock options were granted at \$11.63 per share and 188,750 stock options were granted at \$9.88 per share. Options subject to either of these grants expire October 7, 1995. During the period ended March 3, 1985, 264,200 options were granted at \$8.29 per share and expire September 21, 1994.

Note 9—Stockholders' Equity

On September 20, 1984, the Company issued 3,400,000 shares of common stock in connection with its initial public offering.

On March 20, 1985, the Company issued an additional 400,000 shares of common stock to the public. Subsequent to March 2, 1986, the Company sold 1,495,000 shares of common stock (includes over-allotment option) and received net proceeds of approximately \$37,000,000.

In addition, in connection with the initial public offering, the managing underwriter purchased warrants to acquire an aggregate of 150,000 shares of common stock at a price of \$4.80 per share for \$.50 each. The warrants became exercisable on September 20, 1985 and expire on September 20, 1989.

CRAZY EDDIE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued) (Tables Included in the Accompanying Footnotes are in Thousands Except for Per Share Data)

Note 9—Stockholders' Equity (Continued)

Through May 1, 1986, the underwriters exercised warrants for 103,122 shares, of which 88,621 shares were exercised as of March 2, 1986.

The foregoing information has been adjusted for a 2 for 1 stock split effected in the form of a dividend on July 31, 1985.

In connection with the exercise of nonqualified stock options, \$725,000, representing tax benefits realized by the Company, was credited to additional paid-in capital during the year ended March 2, 1986.

Note 10—Reclassifications

Certain items appearing in the 1984 financial statements have been reclassified to correspond with the current presentation. The reclassifications primarily relate to the presentation of cash surrender value loans and unearned service contract revenue. There was no effect on net income or stockholders' equity as a result of these reclassifications.

Note 11—Revised Fiscal Year Financial Statements (Unaudited)

The following summarizes the operating results of the Company, restated to correspond on a comparative basis to the Company's new fiscal year:

CONSOLIDATED STATEMENT OF OPERATIONS (UNAUDITED)

	Twelve Months Ended		
	March 2, 1986	March 3, 1985	February 29, 1984
Net sales	\$262,268	\$167,147	\$134,347
Cost of goods sold	194,371	127,619	105,313
Gross profit	67,897	39,528	29,034
Selling, general and administrative expense	42,975	26,431	22,056
	24,922	13,097	6,978
Other income	3,210	1,418	692
Interest expense	(820)	(572)	(461)
Income before pension contribution and income taxes	27,312	13,943	7,209
Pension contribution	800	600	627
Income before income taxes	26,512	13,343	6,582
Income taxes	13,268	6,976	3,630
Net income	<u>\$ 13,244</u>	<u>\$ 6,367</u>	<u>\$ 2,952</u>
Net income per share	<u>\$.96</u>	<u>\$.55</u>	<u>\$.30</u>
Weighted average number of shares outstanding	<u>13,832</u>	<u>11,592</u>	<u>10,000</u>

CRAZY EDDIE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Tables Included in the Accompanying Footnotes are in Thousands Except for Per Share Data)

Note 11—Revised Fiscal Year Financial Statements (Unaudited) (Continued)

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION (UNAUDITED)

	Twelve Months Ended		
	March 2, 1986	March 3, 1985	February 29, 1984
Working capital provided from:			
Net income	\$13,244	\$ 6,367	\$ 2,952
Add charges not affecting working capital:			
Depreciation and amortization	1,044	532	471
Loss on disposal of equipment	506	37	
Working capital provided from operations	14,794	6,936	3,423
Issuance of common stock, less issuance costs	5,516	11,808	
Increase in long-term debt	700	8,236	
Reduction in advances to affiliates		8,562	4,375
Decrease in restricted cash	3,702		
Increase in unearned service contract revenue	1,194	332	49
Insurance proceeds		14	
Total working capital provided	<u>25,906</u>	<u>35,888</u>	<u>7,847</u>
Working capital used for:			
Increase in restricted cash		7,058	
Acquisition of property, plant and equipment	4,986	2,491	546
Advances and sales to affiliates, net		2,901	8,895
Construction in process	5,099	1,154	
Reduction in long-term debt	624	671	209
Increase in other assets	4,181	4	294
Deemed dividend			500
Total working capital used	<u>14,890</u>	<u>14,279</u>	<u>10,444</u>
Increase (decrease) in working capital	<u>\$11,016</u>	<u>\$21,609</u>	<u>(\$ 2,597)</u>
Changes in working capital consisted of:			
Increase (decrease) in current assets:			
Cash and short-term investments	\$17,863	\$21,365	(\$ 424)
Due from American Express Co.	371	818	423
Merchandise inventories	33,321	4,579	3,902
Prepaid expenses	853	(155)	573
	<u>52,408</u>	<u>26,607</u>	<u>4,474</u>
Increase (decrease) in current liabilities:			
Loans payable—officers and other		(2,509)	(19)
Current maturities of long-term debt	1,831	(810)	1,101
Accounts payable	28,645	4,893	4,443
Unearned service contract revenue	2,523	465	115
Accrued expenses	8,393	2,959	1,431
	<u>41,392</u>	<u>4,998</u>	<u>7,071</u>
Increase (decrease) in working capital	<u>\$11,016</u>	<u>\$21,609</u>	<u>(\$ 2,597)</u>

CRAZY EDDIE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Tables Included in the Accompanying Footnotes are in Thousands Except for Per Share Data)

Note 12—Quarterly Financial Data (Unaudited)

	Quarter Ended				Total
	June 2, 1985	September 1, 1985	December 1, 1985	March 2, 1986	
Year ended March 2, 1986					
Net sales	\$45,843	\$52,908	\$63,750	\$99,767	\$262,268
Gross profit	10,361	12,762	15,172	29,602	67,897
Net income	1,141	2,389	2,578	7,136	13,244
Earnings per share(b)	\$.08	\$.17	\$.19	\$.51	\$.96
	Quarter Ended			Total	
	August 31, 1984	November 30, 1984	March 3, 1985		
Nine months ended March 3, 1985(a)					
Net sales	\$32,344	\$38,684	\$65,291	\$136,319	
Gross profit	7,519	8,817	16,562	32,898	
Net income	1,141	1,380	3,308	5,829	
Earnings per share(b)	\$.11	\$.11	\$.25	\$.48	

(a) Fiscal 1985 includes only three quarters because of the change in fiscal year.

(b) The sum of the earnings per share for the quarters will not equal the total because of weighting and rounding.