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CELLSTAR CORP
Form 10-Q
October 22, 2001

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended August 31, 2001
or

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

For the transition period from _____ to _____

Commission File Number 0-22972

CELLSTAR CORPORATION
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

75-2479727
(I.R.S. Employer
Identification No.)

1730 Briercroft Court
Carrollton, Texas 75006
Telephone (972) 466-5000

(Address, including zip code and telephone number, including area
code, of registrant's principal executive offices)

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

Yes X No

On October 19, 2001, there were 60,142,221 outstanding shares of Common
Stock, \$0.01 par value per share.

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CELLSTAR CORPORATION
INTRODUCTORY NOTE

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At the time of this filing, our independent auditors have not completed their review procedures as established by general accepted auditing standards and article 10-01(d) of Regulation S-X as of and for the three months ended August 31, 2001.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

CellStar Corporation and Subsidiaries
Consolidated Balance Sheets
(Unaudited)
(Amounts in thousands, except share data)

ASSETS

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Current Assets:

Cash and cash equivalents \$
Restricted cash
Accounts receivable (less allowance for doubtful accounts of
\$60,027 and \$75,810, respectively)
Inventories
Deferred income tax assets
Prepaid expenses

Total current assets

Property and equipment, net
Goodwill (less accumulated amortization of \$7,102 and \$17,408, respectively)
Deferred income tax assets
Other assets

Liabilities and Stockholders' Equity

Current liabilities:

Accounts payable \$
Notes payable
Accrued expenses
Income taxes payable
Deferred income tax liabilities

Total current liabilities

Long-term debt

Total liabilities

Stockholders' equity:

Preferred stock, \$.01 par value, 5,000,000 shares authorized;
none issued
Common stock, \$.01 par value, 200,000,000 shares authorized;
60,142,221 shares issued and outstanding
Additional paid-in capital
Accumulated other comprehensive loss - foreign currency
translation adjustments
Retained earnings

Total stockholders' equity

See accompanying notes to unaudited consolidated financial statements.

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(Unaudited)

(Amounts in thousands, except per share data)

	Three months ended August 31,	
	2001	2000
	-----	-----
Revenues	\$610,496	629,793
Cost of sales	579,427	606,516
	-----	-----
Gross profit	31,069	23,277
Selling, general and administrative expenses	28,684	33,815
Impairment of assets	-	4,930
Separation agreement	5,680	-
Restructuring charge (credit)	-	-
	-----	-----
Operating income (loss)	(3,295)	(15,468)
	-----	-----
Other income (expense):		
Equity in loss of affiliated companies	(122)	(408)
Gain on sale of assets	-	6,200
Interest expense	(3,533)	(5,676)
Impairment of investment	(2,215)	-
Other, net	794	326
	-----	-----
Total other income (expense)	(5,076)	442
	-----	-----
Income (loss) before income taxes	(8,371)	(15,026)
Provision (benefit) for income taxes	(2,531)	(1,121)
	-----	-----
Net income (loss)	\$ (5,840)	(13,905)
	=====	=====
Net income (loss) per share:		
Basic	\$ (0.10)	(0.23)
	=====	=====
Diluted	\$ (0.10)	(0.23)
	=====	=====

See accompanying notes to unaudited consolidated financial statements.

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CellStar Corporation and Subsidiaries
 Consolidated Statement of Stockholders' Equity and Comprehensive Income
 Nine months ended August 31, 2001
 (Unaudited)
 (In thousands)

	Common Stock		Additional paid-in capital	Accumulated other comprehensive loss
	Shares	Amount		
Balance at November 30, 2000	60,142	\$602	81,298	(10,861)
Comprehensive income:				
Net income	-	-	-	-
Foreign currency translation adjustment	-	-		(1,560)
Total comprehensive income			-	
Stock options compensation expense		-	646	-
Balance at August 31, 2001	60,142	\$602	81,944	(12,421)

See accompanying notes to unaudited consolidated financial statements.

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CellStar Corporation and Subsidiaries
 Consolidated Statements of Cash Flows
 Nine months ended August 31, 2001 and 2000
 (Unaudited)
 (In thousands)

	2001
Cash flows from operating activities:	
Net income (loss)	\$ 1
Adjustments to reconcile net income to net cash provided by (used in) operating activities:	
Depreciation, amortization and impairment of assets	8
Equity in loss of affiliated companies	
Gain on sale of assets	
Deferred income taxes	(4)
Stock option compensation expense	
Impairment of investment	2
Changes in operating assets and liabilities net of effects from disposition of business:	
Accounts receivable	142
Inventories	69

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Prepaid expenses	1
Other assets	
Accounts payable	(162)
Accrued expenses	5
Income taxes payable	(2)

Net cash provided by (used in) operating activities	63

Cash flows from investing activities:	
Proceeds from sale of assets	2
Change in restricted cash	2
Purchases of property and equipment	(3)
Acquisition of business, net of cash acquired	
Purchase of investment	
Investment in joint venture	

Net cash provided by (used in) investing activities	

Cash flows from financing activities:	
Repayments on notes payable	(385)
Net borrowings on notes payable	305
Additions to deferred loan costs	(2)
Net proceeds from issuance of common stock	

Net cash provided by (used in) financing activities	(83)

Net decrease in cash and cash equivalents	(19)
Cash and cash equivalents at beginning of period	77

Cash and cash equivalents at end of period	\$ 57
	=====

See accompanying notes to unaudited consolidated financial statements

CellStar Corporation and Subsidiaries
Notes to Consolidated Financial Statements
(Unaudited)

(1) Basis of Presentation

Although the interim consolidated financial statements of CellStar Corporation and subsidiaries (the "Company") are unaudited, Company management is of the opinion that all adjustments (consisting of only normal recurring adjustments) necessary for a fair statement of the results have been reflected therein. Operating revenues and net income for any interim period are not necessarily indicative of results that may be

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expected for the entire year.

These statements should be read in conjunction with the consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K/A for the year ended November 30, 2000 filed July 6, 2001.

Certain prior period financial statement amounts have been reclassified to conform to the current year presentation.

(2) Net Income Per Share

Basic net income per common share is based on the weighted average number of common shares outstanding for the relevant period. Diluted net income per common share is based on the weighted average number of common shares outstanding plus the dilutive effect of potentially issuable common shares pursuant to stock options and convertible notes.

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A reconciliation of the numerators and denominators of the basic and diluted net income per share computations for the three and nine months ended August 31, 2001 and 2000, follows (in thousands, except per share data):

	Three months ended August 31,	
	2001	2000
Basic:		
Net loss	\$ (5,840)	(13,900)
	=====	=====
Weighted average number of shares outstanding	60,142	60,142
	=====	=====
Net loss per share	\$ (0.10)	(0.23)
	=====	=====
Diluted:		
Net loss	\$ (5,840)	(13,900)
Interest on convertible notes, net of tax effect	-	-
	-----	-----
Adjusted net loss	\$ (5,840)	(13,900)
	=====	=====
Weighted average number of shares outstanding	60,142	60,142
Effect of dilutive securities:		
Stock options	-	-
Convertible notes	-	-
	-----	-----
Weighted average number of shares outstanding including effect of dilutive securities	60,142	60,142
	=====	=====
Net loss per share	\$ (0.10)	(0.23)
	=====	=====

Nine months ended
August 31,

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	2001	2000
Basic:		
Net income (loss)	\$ 1,943	(46,88)
Weighted average number of shares outstanding	60,142	60,12
Net income (loss) per share	\$ 0.03	(0.7)
Diluted:		
Net income (loss)	\$ 1,943	(46,88)
Interest on convertible notes, net of tax effect	-	-
Adjusted net income (loss)	\$ 1,943	(46,88)
Weighted average number of shares outstanding	60,142	60,12
Effect of dilutive securities:		
Stock options	8	
Convertible notes	-	
Weighted average number of shares outstanding including effect of dilutive securities	60,150	60,12
Net income (loss) per share	\$ 0.03	(0.7)

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Options outstanding at August 31, 2001, to purchase 7.1 million and 6.0 million shares of common stock for the three and nine months ended August 31, 2001 were not included in the computation of diluted earnings per share (EPS) because their inclusion would have been anti-dilutive.

Options outstanding to purchase 4.7 million shares of common stock for the three and nine months ended August 31, 2000, respectively were not included in the computation of diluted EPS because their inclusion would have been anti-dilutive.

The subordinated convertible notes were not dilutive for the three and nine month periods ended August 31, 2001 and 2000, respectively.

(3) Segment and Related Information

The Company operates predominately within one industry, wholesale and retail sales of wireless telecommunications products. The Company's management evaluates operations primarily on income before interest and income taxes in the following reportable geographical regions: Asia-Pacific, North America, Latin America, which includes Mexico and the Company's Miami, Florida operations ("Miami"), and Europe. Revenues and operating results of Miami are included in Latin America since Miami's activities are primarily for export into Latin America. The Corporate segment includes headquarter operations, primarily general and administrative costs, and income and expenses not allocated to reportable segments. Corporate segment assets primarily consist of cash, cash equivalents and deferred income tax assets. Intersegment sales and

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transfers are not significant.

Segment asset information as of August 31, 2001, and November 30, 2000, follows (in thousands):

	Asia- Pacific	North America	Latin America

Total assets			
August 31, 2001	\$260,604	118,081	123,592
November 30, 2000	289,677	172,527	256,907

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Segment operations information for the three and nine months ended August 31, 2001 and 2000, follows (in thousands):

	Asia- Pacific	North America	Latin America

Three months ended August 31, 2001:			
Revenues from external customers	\$331,720	155,649	69,488
Income (loss) before interest and income taxes	6,197	8,235	(6,671)
Three months ended August 31, 2000:			
Revenues from external customers	270,787	155,653	136,630
Income (loss) before interest and income taxes	(278)	927	(6,985)

Loss before interest and income taxes per segment

information.....

Interest expense per the consolidated statements of

operations.....

Interest income included in other, net in the consolidated statements of

operations.....

Loss before income taxes per the consolidated statements of

operations.....

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	Asia- Pacific -----	North America -----	Latin America -----
Nine months ended August 31, 2001:			
Revenues from external customers	\$939,225	407,154	307,686
Income (loss) before interest and income taxes	19,785	19,302	(5,480)
Nine months ended August 31, 2000:			
Revenues from external customers	744,093	336,063	452,362
Income (loss) before interest and income taxes	12,905	(18,190)	(30,057)

Income (loss) before interest and income taxes per segment information.....
Interest expense per the consolidated statements of operations.....
Interest income included in other, net in the consolidated statements of operations.....
Income (loss) before income taxes per the consolidated statements of operations.....

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(4) Notes Payable

Notes payable consisted of the following at August 31, 2001 and November 30, 2000 (in thousands):

	2001 -----	2000 -----
Multicurrency revolving credit facility	\$ -	82,700
People's Republic of China ("PRC") credit facilities	39,081	44,428
Taiwan notes payable	8,989	-
Peru note payable	2,842	2,842
	-----	-----
	\$50,912	129,970
	=====	=====

As of January 30, 2001, the Company had negotiated an amendment to its Multicurrency Revolving Credit Facility, (the "Facility") that reduced the amount of the Facility from \$100.0 million to \$86.4 million.

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On February 27, 2001, the Company and its banking syndicate negotiated and executed a Second Amended and Restated Credit Agreement that further reduced the amount of the Facility to \$85.0 million on February 27, 2001, \$74.0 million on July 31, 2001, \$65.0 million on September 30, 2001, and \$50.0 million on December 15, 2001. Such Second Amended and Restated Credit Agreement further (i) increased the applicable interest rate margin by 25 basis points, (ii) shortened the term of the Facility from June 1, 2002 to March 1, 2002, (iii) provided additional collateral for such Facility in the form of additional stock pledges and mortgages on real property, (iv) provides for dominion of funds by the banks for the Company's U.S. operations, (v) limited the borrowing base, and (vi) tightened restrictions on the Company's ability to fund its operations, particularly its non-U.S. operations.

As of July 3, 2001, the Company had negotiated an additional amendment to its Facility that reduced the borrowing capacity under the Facility from \$85.0 million to \$40.0 million and waived compliance with a covenant for the quarter ended May 31, 2001.

At August 31, 2001 the Company had no borrowings under the Facility.

As of September 28, 2001, the Company had negotiated and finalized a new, five-year, \$60.0 million Loan and Security Agreement ("New Facility") with a bank and terminated its previously-existing Facility. On October 12, 2001 the Company finalized an amendment to the New Facility increasing the commitment amount from \$60.0 million to \$85.0 million. The New Facility lowers the applicable interest rate margin by 25 basis points from its level at August 31, 2001 of 125 basis points, provides a more extensive borrowing base, more flexible financial covenants and greater flexibility in funding foreign operations.

Fundings under the New Facility are limited by a borrowing base test, which is measured weekly. Interest on borrowings under the New Facility is at the London Interbank Offered Rate or at the bank's prime lending rate, plus an applicable margin. The New Facility is also secured by a pledge of 100% of the outstanding stock of all U.S. subsidiaries and 65% of the outstanding stock of all first tier foreign subsidiaries. The New Facility is further secured by the Company's domestic accounts receivable, inventory, property, plant and equipment and all other domestic real property. The New Facility contains, among other provisions, covenants relating to the maintenance of minimum net worth and certain financial ratios, exchanging, refinancing or extending of the Company's convertible notes, dividend payments, additional debt, mergers and acquisitions and disposition of assets.

As a result of terminating its previously-existing Facility, the Company will have an extraordinary loss on early extinguishment of debt in the fourth quarter of 2001, primarily related to approximately \$1.1 million in deferred loan costs related to the Facility.

At August 31, 2001, the Company's operations in the PRC had two lines of credit, one for USD \$12.5 million and the second for RMB 220 million (approximately USD \$26.6 million), bearing interest at

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7.16%, and from 5.30% to 5.58% respectively. The loans have maturity dates through June 2002. Both lines of credit are fully collateralized by U.S. dollar cash deposits. The cash deposits were made via intercompany loans

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from the operating entity in Hong Kong as a mechanism to secure repatriation of these funds. At August 31, 2001, the U.S. dollar equivalent of \$39.1 million had been borrowed against the lines of credit in the PRC. As a result of this method of funding operations in the PRC, the consolidated balance sheet at August 31, 2001 reflects USD \$40.6 million in cash that is restricted as collateral on these advances and a corresponding USD \$39.1 million in notes payable.

Assuming the Company is able to successfully complete the exchange offer (note 5), the Company anticipates that its cash flow from operations, based on current and anticipated levels of operations and aggressive efforts to reduce inventories and accounts receivable, together with amounts available under its new credit facility and existing unrestricted cash balances, will be adequate to meet its anticipated cash requirements for the foreseeable future. The Company's New Facility requires that the Company refinance, exchange or extend the maturity of at least 80% of the \$150 million principal amount of the Company's 5% Convertible Subordinated Notes due October 2002 (the "Notes") by April 2002, and failure to do so would result in an event of default under the New Facility. If the Company is unable to successfully complete the exchange offer or otherwise refinance or pay off the Notes, it may be faced with the possibility of bankruptcy, because it anticipates cash flow from operations, unrestricted cash balances and available borrowings may be insufficient to meet its cash requirements, including the payment of the Notes.

(5) Exchange Offer

The Company filed a registration statement on September 4, 2001 with the Securities and Exchange Commission for a proposed exchange offer for its Notes. The Company is offering to exchange up to 60,142,221 shares of its common stock and \$20 million in cash for up to \$150 million of outstanding Notes. The 60,142,221 shares would represent 50% of the Company's outstanding common stock on a post-exchange-offer basis. For each \$1,000 principal amount of Notes holders tender in the exchange offer, they would receive approximately 400.94 shares of common stock and \$133.33 in cash.

(6) Separation Agreement

The Company announced on July 6, 2001, that Alan H. Goldfield retired effective immediately from the position of Chairman and CEO and that James L. "Rocky" Johnson, who has served on the Board of Directors since March 1994 became Chairman of the Board, and Terry S. Parker, a member of the Board of Directors and a former President and COO of CellStar, rejoined the Company as Chief Executive Officer. The Company recorded expense of \$5.7 million in the third quarter of 2001 related to the separation agreement between the Company and Alan H. Goldfield. Included in the \$5.7 million charge is a cash payment of \$4.3 million and stock option compensation expense of \$0.6 million.

(7) Impairment of Investment

For the three months ended August 31, 2001, the Company recorded an impairment charge of \$2.2 million to reduce the carrying value of its 3.5 % investment in a Taiwan retailer. Due to the continuing economic and political turmoil in Taiwan, the Company considered its investment in the Taiwan retailer to be permanently impaired. As a result the Company reduced the carrying value of the its 3.5% investment in the retailer to \$1.9 million, which represents the Company's estimate of the fair value of its 3.5% interest in the Taiwan retailer.

(8) Accounting for Derivative Instruments and Hedging Activities

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In June 1998, the Financial Accounting Standards Board issued Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("Statement 133"), amended by Statement 138 issued in June 2000. Effective December 1, 2000, the Company adopted Statement 133. Given the Company's current derivative activities, the adoption of Statement 133 did not have a material effect on the Company's consolidated financial position and results of operations.

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The Company uses various derivative financial instruments as part of an overall strategy to manage the Company's exposure to market risk associated with interest rate and foreign currency exchange rate fluctuations. The Company evaluates the use of interest rate swaps and cap agreements to manage its interest risk on debt instruments, including the reset of interest rates on variable rate debt.

The Company periodically uses foreign currency forward contracts to reduce exposure to exchange rate risks primarily associated with transactions in the regular course of the Company's international operations. The Company consolidates the bulk of its foreign exchange exposure related to intercompany transactions in its international finance subsidiary. The forward contracts establish the exchange rates at which the Company purchases or sells the contracted amount of local currencies for specified foreign currencies at a future date. The Company uses forward contracts, which are short-term in nature (45 days to one year), and receives or pays the difference between the contracted forward rate and the exchange rate at the settlement date.

At August 31, 2001, the Company had French franc forward contracts with a contractual amount of \$1.1 million. The carrying amount and fair value of these contracts are not significant. These derivatives are not accounted for as hedges under Statement 133.

The Company does not hold or issue derivative financial instruments for trading purposes.

(9) Contingencies

Refer to Part II, Item 1, "Legal Proceedings".

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

The Company reported a net loss of \$5.8 million, or \$0.10 per diluted share, for the third quarter of 2001, compared with a net loss of \$13.9 million, or \$0.23 per diluted share, for the same quarter last year. Revenues for the quarter ended August 31, 2001, were \$610.5 million, a decrease of \$19.3 million compared to \$629.8 million in 2000. Excluding revenues of \$34.0 million in the third quarter of 2000 from a major account in North America that has since been converted to a consignment basis,

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revenues increased 2.5% in the current year third quarter. Gross profit increased from \$23.3 million in 2000 to \$31.1 million in 2001. Selling, general and administrative expenses for the third quarter of 2001 were \$28.7 million compared to \$33.8 million in 2000.

The Company announced on July 6, 2001, that Alan H. Goldfield retired effective immediately from the position of Chairman and CEO and that James L. "Rocky" Johnson, who has served on the Board of Directors since March 1994 became Chairman of the Board, and Terry S. Parker, a member of the Board of Directors and a former President and COO of CellStar, rejoined the Company as Chief Executive Officer. The Company recorded expense of \$5.7 million in the third quarter of 2001 related to the separation agreement between the Company and Alan H. Goldfield. Included in the \$5.7 million charge is a cash payment of \$4.3 million and stock option compensation expense of \$0.6 million.

The Company filed a registration statement on September 4, 2001 with the Securities and Exchange Commission for a proposed exchange offer for its 5% Convertible Subordinated Notes due October 2002 (the "Notes"). The Company is offering to exchange up to 60,142,221 shares of its common stock and \$20 million in cash for up to \$150 million of outstanding Notes. The 60,142,221 shares would represent 50% of the Company's outstanding common stock on a post-exchange-offer basis. For each \$1,000 principal amount of Notes holders tender in the exchange offer, they would receive approximately 400.94 shares of common stock and \$133.33 in cash.

In the third quarter of 2000, the Company divested its majority interest in its Brazil joint venture, announced its intent to divest its Venezuela operations, and continued to phase out a major portion of its North America and Miami redistributor business.

Cautionary Statements

The Company's success will depend upon, among other things, its ability to maintain its operating margins, continue to secure an adequate supply of competitive products on a timely basis and on commercially reasonable terms, service its indebtedness and comply with covenants, secure adequate financial resources, continually turn its inventories and accounts receivable, successfully manage growth (including monitoring operations, controlling costs, maintaining adequate information systems and effective inventory and credit controls), manage operations that are geographically dispersed, achieve significant penetration in existing and new geographic markets, and hire, train and retain qualified employees who can effectively manage and operate its business.

The Company's foreign operations are subject to various political and economic risks including, but not limited to, the following: political instability; economic instability; currency controls; currency devaluations; exchange rate fluctuations; potentially unstable channels of distribution; increased credit risks; export control laws that might limit the markets the Company can enter; inflation; changes in laws related to foreign ownership of businesses abroad; foreign tax laws; changes in cost of and access to capital; changes in import/export regulations, including enforcement policies; "gray market" resales; and tariff and freight rates. Political and other factors beyond the control of the Company, including trade disputes among nations, internal political or economic instability in any nation where the Company conducts business, and terrorist acts could have a material adverse effect on the Company.

Assuming the Company is able to successfully complete the exchange offer, the Company anticipates that its cash flow from operations, based on current and anticipated levels of operations and aggressive efforts to

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reduce inventories and accounts receivable, together with amounts available under its new credit facility and existing unrestricted cash balances, will be adequate to meet its anticipated cash requirements for the foreseeable future. The Company's New Facility requires that the Company refinance, exchange or extend the maturity of at least 80% of the \$150 million principal amount of the Notes by April 2002, and failure to do so would result in an event of default under the New Facility. If the Company is unable to successfully complete the exchange offer or otherwise refinance or pay off the Notes, it may be faced with the possibility of bankruptcy, because it anticipates cash flow from operations, unrestricted cash balances and available borrowings may be insufficient to meet its cash requirements, including the payment of the Notes.

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Special Cautionary Notice Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements relating to such matters as anticipated financial performance and business prospects. When used in the Quarterly Report, the words "estimates", "may", "intends", "expects", "anticipates", "could", "should", "will" and similar expressions are intended to be among the statements that identify forward-looking statements. From time to time, the Company may also publish forward-looking statements. The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. In order to comply with the terms of the safe harbor, the Company notes that a variety of factors, including foreign customer and vendor relationships, seasonality, inventory obsolescence and availability, "gray market" resales, and inflation could cause the Company's actual results and experience to differ materially from anticipated results or other expectations expressed in the Company's forward-looking statements.

Results of Operations

The following table sets forth certain unaudited consolidated statements of operations data for the Company expressed as a percentage of revenues for the three and nine months ended August 31, 2001 and 2000:

	Three months ended August 31	
	2001	2000
Revenues	100.0 %	100
Cost of sales	94.9	96
	5.1	3
Gross profit		
Selling, general and administrative expenses	4.7	5
Impairment of assets	-	0
Separation agreement	0.9	
Restructuring charge (credit)	-	
	(0.5)	(2)
Operating income (loss)		
Other income (expense):		
Equity in loss of affiliated companies	-	
Gain on sale of assets	-	1
Interest expense	(0.6)	(0)

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Impairment of investment	(0.4)	
Other, net	0.1	
	-----	-----
Total other income (expense)	(0.9)	0
	-----	-----
Income (loss) before income taxes	(1.4)	(2)
Provision (benefit) for income taxes	(0.4)	(0)
	-----	-----
Net income (loss)	(1.0) %	(2)
	=====	=====

Three Months Ended August 31, 2001 Compared to Three Months Ended August 31, 2000

Revenues. The Company's revenues decreased \$19.3 million, or 3.1%, from \$629.8 million to \$610.5 million.

Revenues in the Asia-Pacific Region increased \$60.9 million, or 22.5%, from \$270.8 million to \$331.7 million. The Company's operations in the People's Republic of China, including Hong Kong ("PRC"), provided \$291.0 million in revenues, an increase of \$105.4 million, or 56.8%, from \$185.6 million. Growth in the PRC, where market penetration of handsets is approximately 10% of the total population, is being driven by the addition of new wireless subscribers. Revenues from the Company's operations in Singapore increased \$11.9 million to \$24.4 million, or 95.5%, due to third party subsidies and sales of two products for which the Company has exclusive rights. Revenues from Taiwan decreased \$55.7 million, or 90.9% to \$5.6 million. The Company's operations in Taiwan continue to be affected by economic and political turmoil in the country. In addition, the Company's supplier base in Taiwan is limited and there are no compelling new products from its major supplier.

North American Region revenues were \$155.6 million compared to \$155.7 million in 2000. Early in the first quarter of 2001, the Company converted a major U.S. account to a consignment basis with fulfillment fees, which will reduce revenue potential for the 2001 fiscal year by approximately \$100

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million. Revenues for the third quarter of 2000 on a comparable basis were \$121.6 million. The conversion to consignment is expected to have minimal impact on net income, but will reduce inventory risk and the need for working capital. The increase on a comparable basis was primarily attributable to market expansion by a regional carrier customer.

The Company's operations in the Latin America Region provided \$69.5 million of revenues, compared to \$136.6 million in 2000, a 49.1% decrease. Revenues in Mexico, the region's largest revenue contributor, were \$41.5 million compared to \$78.2 million in 2000, which benefited from strong carrier promotions. The decrease was also due to reduced business with major carrier customers. The Company sold its 51% interest in its Brazil joint venture in August 2000. Revenues for Brazil were \$14.9 million in last year's third quarter. Revenues from the Venezuela operations were \$4.3 million in 2000. The Company sold its Venezuela operations in December 2000. Revenues from the Company's Miami export operations were \$14.3 million compared to \$20.5 million in the third quarter a year ago. The

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increased availability of in-country manufactured products in South America has reduced exports from Miami. Combined revenues from CellStar's Argentina, Chile, Colombia and Peru operations were \$13.7 million in 2001 and \$18.8 million in 2000.

The Company's European Region operations recorded revenues of \$53.6 million, a decrease of \$13.1 million from \$66.7 million in 2000. The handset market in Europe is highly penetrated and is increasingly driven by replacement sales, which are depressed due to delays in the rollout of new handset technologies and services.

Gross Profit. Gross profit increased \$7.8 million from \$23.3 million to \$31.1 million as a result of increases in the Asia Pacific and North America Regions. These increases are due to better product mix as the Company continues to emphasize inventory management. Gross profit in the Latin America region was lower primarily due to the Company's operations in Mexico. Gross margins in Mexico were significantly impacted by reduced revenues to the Company's major carrier customers. Gross profit in 2000 in Asia was also lower due to the Company's commitment to defend market share. Gross profit in 2000 was lower in North America due in part to efforts to improve the quality of its inventory by reducing the level of analog, satellite, and older model products by selling these products at lower margins.

Selling, General and Administrative Expenses. Selling, general and administrative expenses decreased \$5.1 million from \$33.8 million to \$28.7 million. The decrease is principally due to the divestiture of the Company's operations in Brazil and Venezuela which were sold in August 2000 and December 2000, respectively. In the third quarter of 2000, Brazil and Venezuela incurred expenses of \$3.8 million and \$3.1 million, respectively. These decreases were partially offset by increases due to costs associated with business expansion activities in payroll and professional fees. Selling, general and administrative expenses as a percentage of revenues were 4.7% and 5.4% for 2001 and 2000, respectively.

Impairment of Assets. In the third quarter 2000, the Company decided to exit its Venezuela operations. The Company recorded a \$4.9 million impairment charge to reduce the carrying value of certain Venezuelan assets, primarily goodwill, to their estimated fair value (see "International Operations").

Separation Agreement. The Company announced on July 6, 2001, that Alan H. Goldfield retired effective immediately from the position of Chairman and CEO and that James L. "Rocky" Johnson, who has served on the Board of Directors since March 1994 became Chairman of the Board, and Terry S. Parker, a member of the Board of Directors and a former President and COO of CellStar, rejoined the Company as Chief Executive Officer. The Company recorded expense of \$5.7 million in the third quarter of 2001 related to the separation agreement between the Company and Alan H. Goldfield. Included in the \$5.7 million charge is a cash payment of \$4.3 million and stock option compensation expense of \$0.6 million.

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Equity in Loss of Affiliated Companies. Equity in loss of affiliated companies was \$0.4 million in 2000 due to losses from the Company's 49% minority interest in CellStar Amtel. As a result of the continuing deterioration in the Malaysia market, the Company intends to liquidate its

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ownership in CellStar Amtel to limit further exposure. The Company will be required to recognize future losses, if any, of CellStar Amtel up to the amount of debt and payables of CellStar Amtel guaranteed by the Company. The Company currently estimates the remaining exposure to be up to \$1.0 million.

Gain on Sale of Assets. In third quarter of 2000, the Company recorded a pre-tax gain of \$6.0 million, from the completion of the divestiture of its 51% ownership interest in its Brazil joint venture. During the third quarter 2000, the Company also completed the sale of its Poland operations and recognized a pre-tax gain of \$0.2 million.

Interest Expense. Interest expense decreased to \$3.5 million from \$5.7 million. This decrease was primarily related to the elimination of debt of the Brazil operation, which was sold in August 2000. The decrease was also a result of lower borrowing levels on the Company's Multicurrency Revolving Credit Facility, partially offset by an increase in the amortization of deferred loan costs as a result of the reduction in the amount of the Facility.

Impairment of Investment. The Company recorded a \$2.2 million impairment charge in the third quarter of 2001 to reduce the carrying value of its 3.5% investment in a Taiwan retailer. Due to the continuing economic and political turmoil in Taiwan, the Company considered its investment in the Taiwan retailer to be permanently impaired. As a result the Company reduced the carrying value of the its 3.5% investment in the retailer to \$1.9 million which represents the Company's estimate of the fair value of its 3.5% interest in the Taiwan retailer.

Other, Net. Other, net increased \$0.5 million, from income of \$0.3 million to income of \$0.8 million, primarily due to losses in the second quarter of 2000 on foreign currencies related to European operations.

Income Taxes. Income tax benefit increased from a benefit of \$1.1 million in 2000 to a benefit of \$2.5 million in 2001. The Company reduced its 2001 estimated annual effective tax rate from 29% at the end of the second quarter to 25% due to changes in the expected geographical mix of income before tax. Included in the third quarter of 2001 is the benefit related to this reduction.

Nine Months Ended August 31, 2001 Compared to Nine Months Ended August 31, 2000

Revenues. The Company's revenues increased \$47.5 million, or 2.7%, from \$1,781.0 million to \$1,828.5 million.

Revenues in the Asia-Pacific Region increased \$195.1 million, or 26.2%, from \$744.1 million to \$939.2 million. The Company's operations in the PRC provided \$817.0 million in revenue, an increase of \$310.2 million, or 61.2%, from \$506.8 million. Growth in the PRC, where market penetration of handsets is approximately 10% of the total population, is being driven by the addition of new wireless subscribers. Revenues from the Company's operations in Singapore increased \$31.7 million, or 101.6%, to \$62.9 million due to third party subsidies and new products, including sales of two products for which the Company has exclusive rights. Revenues from Taiwan and The Philippines operations decreased \$138.1 million, or 84.4%, and \$8.7 million, or 20.5%, respectively to \$25.5 million and \$33.8 million, respectively. The Company's operations in Taiwan and The Philippines continue to be affected by economic and political turmoil in the respective countries. In addition, the Company's supplier base in Taiwan is limited and there are no new compelling products from its major supplier.

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North American Region revenues were \$407.2 million, an increase of \$71.1 million, or 21.2% when compared to \$336.1 million. U.S. revenues continued to benefit from strong promotional activity by several customers, as well as from the addition of new customers and expanded markets. Early in the first quarter of 2001, the Company converted a major U.S. account to a consignment basis with fulfillment fees, which will reduce revenue potential for the 2001 fiscal year by approximately \$100 million. Revenues for the nine months ended August 31, 2001 and August 31, 2000, on a comparable basis were

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\$376.4 million and \$284.8 million, respectively. The conversion to consignment is expected to have minimal impact on net income, but will reduce inventory risk and the need for working capital.

The Latin American Region provided \$307.7 million of revenues, compared to \$452.4 million, or a 32.0% decrease. Revenues in Mexico decreased \$76.5 from \$261.0 million in 2000, which benefited from strong carrier promotions, to \$184.5 million in 2001. The decrease was primarily due to reduced promotional activities by carrier customers and to reduced business with carrier customers. Revenues for Brazil were \$40.6 million in 2000. The Company's sold its Brazil operations in August 2000. Revenues from the Venezuela operations were \$30.6 million in 2000. The Company sold its Venezuela operations in December 2000. Revenues from the Company's operations in Miami decreased \$24.1 million from 2000 as increased product availability from in-country manufacturers in Latin America continued to reduce exports from Miami. The Company phased out a major portion of its redistributor business in its Miami and North American operations, starting in the second quarter of 2000, due to the volatility of the redistributor business, the relatively lower margins, and higher credit risks. As a result the Company restructured its Miami operation to reduce the size and cost of these operations, resulting in a charge of \$0.8 million in the second quarter of 2001. Combined revenues from the operations in Argentina, Chile, Colombia and Peru increased \$25.9 million to \$83.6 million primarily due to significant promotional activity by a major carrier in Colombia during the first quarter of 2001.

The Company's Europe Region recorded revenues of \$174.5 million, a decrease of \$74.0 million, or 29.8%, from \$248.5 million, primarily due to the Company's decision to curtail its U.K. international trading operations in April 2000 (see "International Operations"). The handset market in Europe is also highly penetrated and is increasingly driven by replacement sales, which are depressed due to delays in the rollout of new handset technologies and services.

Gross Profit. Gross profit increased \$25.4 million from \$74.7 million to \$100.1 million. During 2000, the Company incurred \$29.2 million in inventory obsolescence primarily as a result of price declines during the second quarter and \$3.2 million in third party theft and fraud losses related to the U.K. international trading operations. In 2001, the Company incurred \$6.3 million in obsolescence. The increase in gross profit as a percentage was due to better inventory management and product mix.

Selling, General and Administrative Expenses. Selling, general and administrative expenses decreased \$43.2 million from \$124.1 million to \$80.9 million. This decrease was principally due to a reduction in bad debt

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expense of \$29.0 million from \$33.3 million to \$4.3 million in 2001. The bad debt expense in 2000 was primarily from certain U.S.-based accounts receivable, the collectibility of which had deteriorated significantly in the second quarter of 2000 and which were further affected by the Company's decision to sell its majority interest in its joint venture in Brazil and the phase out of a major portion of the redistributor business in its Miami and North America operations. Bad debt expense in 2001, includes a recovery of \$3.9 million related to a receivable from a satellite handset customer which was reserved in the fourth quarter of 2000. Selling, general and administrative expenses related to the Brazil and Venezuela operations, which were sold in August 2000 and December 2000, respectively, were \$0.2 million in 2001 and \$16.9 million in 2000 and included \$2.3 million in bad debt expense.

Impairment of Assets. In the third quarter 2000, the Company decided to exit its Venezuela operations. The Company recorded a \$4.9 million impairment charge to reduce the carrying value of certain Venezuelan assets, primarily goodwill, to their estimated fair value (see "International Operations").

Separation Agreement. The Company announced on July 6, 2001, that Alan H. Goldfield retired effective immediately from the position of Chairman and CEO and that James L. "Rocky" Johnson, who has served on the Board of Directors since March 1994 became Chairman of the Board, and Terry S. Parker, a member of the Board of Directors and a former President and COO of CellStar, rejoined the Company as Chief Executive Officer. The Company recorded expense of \$5.7 million in the third quarter of 2001 related to the separation agreement between the Company and Alan H. Goldfield. Included in the \$5.7 million charge is a cash payment of \$4.3 million and stock option compensation expense of \$0.6 million.

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Restructuring Charge (Credit). In connection with its previously announced intent, the Company restructured its Miami facilities in the second quarter of 2001 to reduce the size and cost of those operations, resulting in a charge of \$0.8 million, primarily related to the impairment of leasehold improvements.

Equity in Loss of Affiliated Companies. Equity in loss of affiliated companies was \$0.8 million in both 2001 and 2000 primarily due to losses from the Company's 49% minority interest in CellStar Amtel. As a result of the continuing deterioration in the Malaysia market, the Company intends to liquidate its ownership in CellStar Amtel to limit further exposure. The Company will be required to recognize future losses, if any, of CellStar Amtel up to the amount of debt and payables of CellStar Amtel guaranteed by the Company. The Company currently estimates the remaining exposure to be up to \$1.0 million.

Gain on Sale of Assets. The Company recorded a gain on sale of assets of \$0.9 million in 2001 primarily associated with the sale of its Venezuela operations in December 2000. In third quarter of 2000, the Company recorded a pre-tax gain of \$6.0 million, from the completion of the divestiture of its 51% ownership interest in its Brazil joint venture. During the third quarter 2000, the Company also completed the sale of its Poland operations and recognized a pre-tax gain of \$0.2 million.

Interest Expense. Interest expense decreased to \$12.5 million in 2001

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from \$14.4 million in 2000. This decrease was primarily related to the elimination of debt of the Brazil operation, which was sold in August 2000.

Impairment of Investment. For the three months ended August 31, 2001, the Company recorded an impairment charge of \$2.2 million to reduce the carrying value of its 3.5 % investment in a Taiwan retailer. Due to the continuing economic and political turmoil in Taiwan, the Company considered its investment in the Taiwan retailer to be permanently impaired. As a result the Company reduced the carrying value of the its 3.5% investment in the retailer to \$1.9 million which represents the Company's estimate of the fair value of its 3.5% interest in the Taiwan retailer.

Other, Net. Other, net increased \$3.6 million, from income of \$0.7 million to income of \$4.3 million, primarily due to gains on foreign currencies related to European operations in 2001 compared with losses in 2000.

Income Taxes. Income tax expense increased from a benefit of \$15.6 million in 2000 to expense of \$0.6 million in 2001 due to the changes in pretax income. The Company's annual effective tax rate for both 2001 and 2000 was 25%.

International Operations

The Company's foreign operations are subject to various political and economic risks including, but not limited to, the following: political instability; economic instability; currency controls; currency devaluations; exchange rate fluctuations; potentially unstable channels of distribution; increased credit risks; export control laws that might limit the markets the Company can enter; inflation; changes in laws related to foreign ownership of businesses abroad; foreign tax laws; trade disputes among nations; changes in cost of capital; changes in import/export regulations, including enforcement policies, "gray market" resales, tariff and freight rates. Such risks and other factors beyond the control of the Company in any nation where the Company conducts business could have a material adverse effect on the Company.

During the third quarter ended August 31, 2000, the Company decided, based on the current and future economic and political outlook in Venezuela, to divest its operations in Venezuela. For the quarter ended August 31, 2000, the Company recorded an impairment charge of \$4.9 million to reduce the carrying value of certain Venezuela assets, primarily goodwill, to their estimated fair value. In December 2000, the Company completed the sale of its Venezuela operations and recorded a gain of \$1.1 million.

The Company's sales from its Miami operations to customers exporting into South American countries continued to decline as a result of increased in- country manufactured product availability in South

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America, primarily Brazil. In the second quarter of 2000, the Company phased out a major portion of its redistributor business in Miami. In connection with its previously announced intent, the Company restructured its Miami facilities in the second quarter of 2001 to reduce the size and cost of those operations, resulting in a charge of \$0.8 million, primarily related to the impairment of leasehold improvements.

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As a result of the continuing deterioration in the Malaysia market, the Company intends to limit further exposure by divesting its 49% ownership in CellStar Amtel. The carrying value of the investment at August 31, 2001 was \$35,000. During the quarter ended February 28, 2001, the Company incurred a \$0.7 million loss related to the operations of CellStar Amtel. No additional losses were incurred in the quarters ended May 31, 2001 and August 31, 2001. The Company will be required to recognize future losses, if any, of CellStar Amtel up to the amount of debt and payables of CellStar Amtel guaranteed by the Company. The Company currently estimates the remaining exposure to be up to \$1 million.

In April 2000, the Company curtailed a significant portion of its U.K. international trading operations following third party theft and fraud losses. The trading business involves the purchase of products from suppliers other than manufacturers and the sale of those products to customers other than network operators or their dealers and other representatives. Since then the Company has experienced operating losses in its U.K. operation.

Liquidity and Capital Resources

During the nine months ended August 31, 2001, the Company relied primarily on cash available at November 30, 2000, funds generated from operations and borrowings under its Revolving Credit Facility (the "Facility") to fund working capital, capital expenditures and expansions. At August 31, 2001, the Company had no borrowings under the Facility.

At August 31, 2001, the Company's operations in the PRC had two lines of credit, one for USD \$12.5 million and the second for RMB 220 million (approximately USD \$26.6 million), bearing interest at 7.16%, and from 5.30% to 5.58% respectively. The loans have maturity dates through June 2002. Both lines of credit are fully collateralized by U.S. dollar cash deposits. The cash deposits were made via intercompany loans from the operating entity in Hong Kong as a mechanism to secure repatriation of these funds. At August 31, 2001, the U.S. dollar equivalent of \$39.1 million had been borrowed against the lines of credit in the PRC. As a result of this method of funding operations in the PRC, the consolidated balance sheet at August 31, 2001 reflects USD \$40.6 million in cash that is restricted as collateral on these advances and a corresponding USD \$39.1 million in notes payable.

In addition, the Company has notes payable in Taiwan and Peru totaling \$11.8 million.

As of September 28, 2001, the Company had negotiated and finalized a new, five-year, \$60.0 million Loan and Security Agreement ("New Facility") with a bank and terminated its previously-existing Facility. On October 12, 2001 the Company finalized an amendment to the New Facility increasing the commitment amount from \$60.0 million to \$85.0 million. The New Facility lowers the applicable interest rate margin by 25 basis points from its level at August 31, 2001 of 125 basis points, provides a more extensive borrowing base, more flexible financial covenants and greater flexibility in funding foreign operations.

Fundings under the New Facility are limited by a borrowing base test, which is measured weekly. Interest on borrowings under the New Facility is at the London Interbank Offered Rate or at the bank's prime lending rate, plus an applicable margin. The New Facility is also secured by a pledge of 100% of the outstanding stock of all U.S. subsidiaries and 65% of the outstanding stock of all first tier foreign subsidiaries. The New Facility is further secured by the Company's domestic accounts receivable, inventory, property, plant and equipment and all other domestic real property. The New Facility contains, among other provisions, covenants relating to the maintenance of minimum net worth and

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certain financial ratios, exchanging, refinancing or extending of the Company's convertible notes, dividend payments, additional debt, mergers and acquisitions and disposition of assets. At October 19, 2001 the Company had no borrowings under the New Facility.

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As a result of terminating its previously-existing Facility, the Company will have an extraordinary loss on early extinguishment of debt in the fourth quarter of 2001, primarily related to approximately \$1.1 million in deferred loan costs related to the Facility.

The Company filed a registration statement on September 4, 2001 with the Securities and Exchange Commission for a proposed exchange offer for its 5% Convertible Subordinated Notes due October 2002 (the "Notes"). The Company is offering to exchange up to 60,142,221 shares of its common stock and \$20 million in cash for up to \$150 million of outstanding Notes. The 60,142,221 shares would represent 50% of the Company's outstanding common stock on a post-exchange-offer basis. For each \$1,000 principal amount of Notes holders tender in the exchange offer, they would receive approximately 400.94 shares of common stock and \$133.33 in cash.

Cash, cash equivalents, and restricted cash at August 31, 2001 were \$97.8 million, compared to \$119.6 million at November 30, 2000, primarily reflecting the use of the cash to reduce the Facility and accounts payable.

Compared to November 30, 2000, accounts receivable decreased from \$346.0 million to \$199.4 million. Inventories declined to \$195.4 million, from \$265.6 million at November 30, 2000. Management has worked aggressively to reduce accounts receivable and inventory levels through tightening of credit policies, aggressive collection efforts, and better purchasing and inventory management. Accounts payable declined to \$193.9 million, compared to \$361.0 million at November 30, 2000.

Assuming the Company is able to successfully complete the exchange offer, the Company anticipates that its cash flow from operations, based on current and anticipated levels of operations and aggressive efforts to reduce inventories and accounts receivable, together with amounts available under its new credit facility and existing unrestricted cash balances, will be adequate to meet its anticipated cash requirements for the foreseeable future. The Company's New Facility requires that the Company refinance, exchange or extend the maturity of at least 80% of the \$150 million principal amount of the Notes by April 2002, and failure to do so would result in an event of default under the New Facility. If the Company is unable to successfully complete the exchange offer or otherwise refinance or pay off the Notes, it may be faced with the possibility of bankruptcy, because it anticipates cash flow from operations, unrestricted cash balances and available borrowings may be insufficient to meet its cash requirements, including the payment of the Notes.

Accounting Pronouncement Not Yet Adopted

In December 1999, the SEC staff issued Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements" ("SAB 101"). SAB 101 summarizes certain of the staff's views in applying generally accepted accounting principles to revenue recognition and accounting for deferred costs in the financial statements and is effective no later than the fourth quarter of fiscal years beginning after December 15, 1999. Based on the Company's current revenue recognition policies, SAB 101 is not expected to materially impact the Company's

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financial position and consolidated results of operations.

In June 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("Statement") No. 141, "Business Combinations." Statement No. 141 changes the accounting for business combinations to eliminate the pooling-of-interests method and requires all business combinations initiated after June 30, 2001 to be accounted for using the purchase method. This statement also requires intangible assets that arise from contractual or other legal rights, or that are capable of being separated or divided from the acquired entity be recognized separately from goodwill. Existing intangible assets and goodwill that were acquired in a prior purchase business combination must be evaluated and any necessary reclassifications must be made in order to conform with the new criteria in Statement No. 141 for recognition apart from goodwill. The Company does not expect

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the adoption of this statement to have a material effect on its consolidated results of operations or financial position.

In June 2001, the FASB issued Statement No. 142, "Goodwill and Other Intangible Assets." Statement No. 142 addresses the initial recognition and measurement of intangible assets acquired (other than those acquired in a business combination, which is addressed by Statement No. 141) and the subsequent accounting for goodwill and other intangible assets after initial recognition. Statement No. 142 eliminates the amortization of goodwill and intangible assets with indefinite lives. Intangible assets with lives restricted by contractual, legal, or other means will continue to be amortized over their useful lives. Adoption of this statement will also require the Company to reassess the useful lives of all intangible assets acquired, and make any necessary amortization period adjustments. Goodwill and other intangible assets not subject to amortization will be tested for impairment annually, or more frequently if events or changes in circumstances indicate that the asset might be impaired. Statement No.142 requires a two-step process for testing goodwill for impairment. First, the fair value of each reporting unit will be compared to its carrying value to determine whether an indication of impairment exists. If an impairment is indicated, then the fair value of the reporting unit's goodwill will be determined by allocating the unit's fair value to its assets and liabilities (including any unrecognized intangible assets) as if the reporting unit had been acquired in a business combination. The amount of impairment for goodwill and other intangible assets will be measured as the excess of its carrying value over its fair value. Goodwill and intangible assets acquired after June 30, 2001 will be immediately subject to the amortization provisions of this statement. For goodwill and other intangible assets acquired on or before June 30, 2001, the Company is required to adopt Statement No. 142 no later than the beginning of fiscal 2003, with early application permitted during the first quarter of fiscal 2002. The Company does not expect the adoption of this statement to have a material effect on its consolidated results of operations or financial position.

In June 2001, the FASB issued Statement No. 143, Accounting for Asset Retirement Obligations, which addresses financial accounting and reporting obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The standard applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and (or) normal use of the asset. Statement No. 143 requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a

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reasonable estimate of fair value can be made. The fair value of the liability is added to the carrying amount of the associated asset and this additional carrying amount is depreciated over the life of the asset. The liability is accreted at the end of each period through charges to operating expense. If the obligation is settled for other than the carrying amount of the liability, the Company will recognize a gain or loss on settlement. The Company is required to adopt the provisions of Statement No. 143 no later than the beginning of fiscal year 2003, with early adoption permitted. The Company does not expect the adoption of this statement to have a material effect on its consolidated results of operations or financial position.

In October 2001, the FASB issued Statement No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, which addresses financial accounting and reporting for the impairment or disposal of long-lived assets. While Statement No. 144 supersedes FASB Statement No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of, it retains many of the fundamental provisions of that Statement. Statement No. 144 becomes effective for fiscal years beginning after December 15, 2001, with early applications encouraged. The Company does not expect the adoption of this statement to have a material effect on its consolidated results of operations or financial position.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Foreign Exchange Risk

For the quarters ended August 31, 2001 and 2000, the Company recorded in other income (expense), net foreign currency gains and (losses) of \$92,000 and \$(0.9) million, respectively. The losses in 2000 were primarily due to the revaluations of foreign currency related to the Company's European operations.

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Regarding the intercompany advances from the Hong Kong entity to the PRC entity, the Company has foreign exchange exposure on the funds as they have been effectively converted into RMB.

The Company manages foreign currency risk by attempting to increase prices of products sold at or above the anticipated exchange rate of the local currency relative to the U.S. dollar, by indexing certain of its accounts receivable to exchange rates in effect at the time of their payment and by entering into foreign currency hedging instruments in certain instances. The Company consolidates the bulk of its foreign exchange exposure related to intercompany transactions in its international finance subsidiary. These transactional exposures are managed using various derivative alternatives depending on the length and size of the exposure. The Company continues to evaluate foreign currency exposures and related protection measures.

Derivative Financial Instruments

The Company uses various derivative financial instruments as part of an overall strategy to manage the Company's exposure to market risk associated with interest rate and foreign currency exchange rate fluctuations. The Company periodically uses foreign currency forward contracts to manage the foreign currency exchange rate risks associated with international operations. The Company evaluates the use of interest rate swaps and cap agreements to manage its interest risk on debt

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instruments, including the reset of interest rates on variable rate debt. The Company does not hold or issue derivative financial instruments for trading purposes.

The risk of loss to the Company in the event of non-performance by any counterparty under derivative financial instrument agreements is not significant. Although the derivative financial instruments expose the Company to market risk, fluctuations in the value of the derivatives are mitigated by expected offsetting fluctuations in the matched instruments.

The Company uses foreign currency forward contracts to reduce exposure to exchange rate risks primarily associated with transactions in the regular course of the Company's international operations. The forward contracts establish the exchange rates at which the Company purchases or sells the contracted amount of local currencies for specified foreign currencies at a future date. The Company uses forward contracts, which are short-term in nature (45 days to one year), and receives or pays the difference between the contracted forward rate and the exchange rate at the settlement date.

At August 31, 2001, the Company had French franc forward contract with a contractual amount of \$1.1 million. The carrying amount and fair value of these contracts are not significant. These derivatives are not accounted for as hedges under Statement 133.

Interest Rate Risk

The interest rate of the Company's previous Facility and New Facility is an index rate at the time of borrowing plus an applicable margin on certain borrowings. The interest rate is based on either the agent bank's prime lending rate or the London Interbank Offered Rate. Additionally, the applicable margin is subject to increases as the Company's ratio of consolidated funded debt to consolidated cash flow increases. During the quarter ended August 31, 2001, the interest rates of borrowings under the Facility ranged from 7.75% to 8.50%. A one percent change in variable interest rates will not have a material impact on the Company. The Company manages its borrowings under the Facility each business day to minimize interest expenses.

The Company has short-terms borrowings in the PRC as discussed in Liquidity and Capital Resources. The notes payable in Taiwan bear interest at 5.98% and 7.2%, respectively, and the note payable in Peru does not bear interest.

The Company's \$150.0 million in long-term debt has a fixed coupon interest rate of 5.0% and is due in October 2002.

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Part II - OTHER INFORMATION

Item 1. Legal Proceedings

During the period from May 1999 through July 1999, seven purported class action lawsuits were filed in the United States District Court for the Southern District of Florida, Miami Division, styled as follows: (1) Elfie Echavarri v. CellStar Corporation, Alan H. Goldfield, Richard M. Gozia and Mark Q. Huggins; (2) Mark Krug v. CellStar Corporation, , Alan H.

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Goldfield, Richard M. Gozia and Mark Q. Huggins; (3) Jewell Wright v. CellStar Corporation, , Alan H. Goldfield, Richard M. Gozia and Mark Q. Huggins; (4) Theodore Weiss v. CellStar Corporation, , Alan H. Goldfield, Richard M. Gozia and Mark Q. Huggins; (5) Tony LaBella v. CellStar Corporation, , Alan H. Goldfield, Richard M. Gozia and Mark Q. Huggins; (6) Thomas F. Petrone v. CellStar Corporation, , Alan H. Goldfield, Richard M. Gozia and Mark Q. Huggins; and (7) Adele Brody v. CellStar Corporation, , Alan H. Goldfield, Richard M. Gozia and Mark Q. Huggins. Each of the above lawsuits sought certification as a class action to represent those persons who purchased the publicly traded securities of the Company during the period from March 19, 1998, to September 21, 1998. Each of these lawsuits alleges that the Company issued a series of materially false and misleading statements concerning the Company's results of operations and investment in Topp Telecom, Inc. ("Topp"), resulting in violations of Section 10(b) and 20(a) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and Rule 10b-5 promulgated thereunder.

The Court entered an order on September 26, 1999 consolidating the above lawsuits and appointing lead plaintiffs and lead plaintiffs' counsel. On November 8, 1999, the lead plaintiffs filed a consolidated complaint. The Company filed a Motion to Dismiss the consolidated complaint and the Court granted that motion on August 3, 2000. The plaintiffs filed a Second Amended and Consolidated Complaint on September 1, 2000, essentially re-alleging the violations of Sections 10(b) and 20(a) of the Exchange Act, and Rule 10b-5 promulgated thereunder. The Company filed a Motion to Dismiss plaintiffs' Second Amended and Consolidated Complaint on November 2, 2000. On September 28, 2001, the Court entered an order and judgement to dismiss the consolidated complaint with prejudice, and closed the consolidated action for administrative purposes.

On August 3, 1998, the Company announced that the Securities and Exchange Commission (SEC) was conducting an investigation of the Company relating to its compliance with federal securities laws. On June 28, 2001, the Company announced that the SEC has terminated the investigation with no enforcement action recommended.

The Company is a party to various other claims, legal actions and complaints arising in the ordinary course of business.

Management believes that the disposition of these matters will not have a materially adverse effect on the consolidated financial condition or results of operations of the Company.

Item 6. Exhibits and Reports on Form 8-K

(A) Exhibits.

3.1 Amended and Restated Certificate of Incorporation of CellStar Corporation ("Certificate of Incorporations"). (1)

3.2 Certificate of Amendment to Certificate of Incorporation. (7)

3.3 Amended and Restated Bylaws of CellStar Corporation. (8)

4.1 The Certificate of Incorporation, Certificate of Amendment to Certificate of Incorporation and Amended and Restated Bylaws of CellStar Corporation filed as Exhibits 3.1, 3.2, and 3.3 are incorporated into this item by reference. (1) (7) (3) (8)

4.2 Specimen Common Stock Certificate of CellStar Corporation. (2)

- 4.3 Rights Agreement, dated as of December 30, 1996, by and between CellStar Corporation and ChaseMellon Shareholder Services, L.L.C., as Rights Agent ("Rights Agreement"). (4)
- 4.4 First Amendment to Rights Agreement, dated as of June 18, 1997. (5)
- 4.5 Form of Certificate of Designation, Preference and Rights of Series A Preferred Stock of CellStar Corporation ("Certificate of Designations"). (4)
- 4.6 Form of Rights Certificate. (4)
- 4.7 Certificate of Correction of Certificate of Designations. (5)
- 4.8 Indenture, dated as of October 14, 1997, by and between CellStar Corporation and the Bank of New York, as Trustee. (6)
- 10.1 Loan and Security Agreement, dated as of September 28, 2001, by and among CellStar Corporation and Each Of It's Subsidiaries That Are Signatories Thereto, as Borrowers, The Lenders That Are Signatories Thereto, as the Lenders and Foothill Capital Corporation, as the Arranger and Administrative Agent. (9)
- 10.2 First Amendment To Loan Agreement, dated as of October 12, 2001, by and among CellStar Corporation and Each Of It's Subsidiaries That Are Signatories Thereto, as Borrowers, The Lenders That Are Signatories Thereto, as the Lenders and Foothill Capital Corporation, as the Arranger and Administrative Agent. (9)
- 10.3 Exhibit A to Consulting Agreement, dated as of July 5, 2001, by and among CellStar Corporation and Alan H. Goldfield. (9) (10)

-
- (1) Previously filed as an exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended August 31, 1995, and incorporated herein by reference.
 - (2) Previously filed as an exhibit to the Company's Annual Report on Form 10-K for the fiscal year ended November 30, 1995, and incorporated herein by reference.
 - (3) Previously filed as an exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended February 29, 1996, and incorporated herein by reference.
 - (4) Previously filed as an exhibit to the Company's Registration Statement on Form 8 - A (File No. 000-22972), filed January 3, 1997, and incorporated herein by reference.
 - (5) Previously filed as an exhibit to the Company's Registration Statement on Form 8-A/A, Amendment No.1 (File No. 000-22972), filed June 30, 1997, and incorporated herein by reference.
 - (6) Previously filed as an exhibit to the Company's Current Report on Form

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8-K dated October 8, 1997, filed October 24, 1997, and incorporated herein by reference.

- (7) Previously filed as an exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended May 31, 1998, and incorporated herein by reference.
- (8) Previously filed as an exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended May 31, 2001.

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- (9) Filed herewith.
- (10) The exhibit is a management contract or compensatory plan or agreement.
- (B) Reports on Form 8-K
None.

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Signatures

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

CELLSTAR CORPORATION

/s/ AUSTIN P. YOUNG

By: Austin P. Young
Senior Vice President, Chief Financial
Officer and Treasurer
(Principal Financial Officer)

/s/ RAYMOND L. DURHAM

By: Raymond L. Durham
Vice President, Corporate Controller
(Principal Accounting Officer)

Date: October 22, 2001

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EXHIBIT INDEX

Exhibit No.	Description
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