

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

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 1999 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 **0-21796**

CDW Computer Centers, Inc.

(Exact name of registrant as specified in its charter)

Illinois

(State or other jurisdiction of incorporation or organization)

36-3310735

(I.R.S. Employer Identification No.)

200 N. Milwaukee Ave.
Vernon Hills, Illinois

(Address of principal executive offices)

60061

(Zip Code)

(847) 465-6000

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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

Yes _____ No _____

Applicable only to issuers involved in bankruptcy proceedings during the preceding five years:

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court.

Yes _____ No _____

Applicable only to corporate issuers:

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

As of November 15, 1999, 43,314,278 common shares were issued and 43,214,278 were outstanding.

CDW COMPUTER CENTERS, INC.

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Part 1. Financial Information
Item 1. Financial Statements

CDW COMPUTER CENTERS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands)
(unaudited)

	<u>September 30,</u> <u>1999</u>	<u>December 31,</u> <u>1998</u>
Assets		
Current assets :		
Cash and cash equivalents	\$ 16,296	\$ 4,230
Marketable securities	76,562	66,458
Accounts receivable, net of allowance for doubtful accounts of \$4,300 and \$3,185, respectively	242,700	152,308
Miscellaneous receivables	6,400	5,896
Merchandise inventory	87,142	64,392
Prepaid expenses and other assets	1,223	1,423
Deferred income taxes	4,886	5,081
	<hr/>	<hr/>
Total current assets	435,209	299,788
Property and equipment, net	38,509	37,056
Deferred income taxes and other assets	7,125	4,977
	<hr/>	<hr/>
Total assets	\$ 480,843	\$ 341,821
Liabilities and Shareholders' Equity		
Current liabilities :		
Accounts payable	\$ 98,947	\$ 41,358
Accrued expenses :		
Compensation	20,555	16,279
Income taxes	-	5,146
Exit costs	2,262	2,715
Other	6,614	5,560
	<hr/>	<hr/>
Total current liabilities	128,378	71,058
Commitments and contingencies		
Shareholders' equity :		
Preferred shares, \$1.00 par value; 5,000 shares authorized; none issued	-	-
Common shares, \$.01 par value; 75,000 shares authorized; 43,266 and 43,142 shares issued, respectively	217	216
Paid-in capital	94,477	81,352
Retained earnings	260,446	192,259
Unearned compensation	(586)	(975)
Subtotal shareholders' equity	<hr/> 354,554	<hr/> 272,852
Less cost of common shares in treasury, 100 shares	<hr/> (2,089)	<hr/> (2,089)
Total shareholders' equity	<hr/> 352,465	<hr/> 270,763
Total liabilities and shareholders' equity	\$ 480,843	\$ 341,821

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

CDW COMPUTER CENTERS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(in thousands, except per share data)
(unaudited)

	Three Months		Nine Months	
	Ended September 30,		Ended September 30,	
	1999	1998	1999	1998
Net sales	\$ 683,012	\$ 462,720	\$ 1,819,972	\$ 1,256,256
Cost of sales	<u>597,398</u>	<u>403,857</u>	<u>1,591,705</u>	<u>1,096,539</u>
Gross profit	85,614	58,863	228,267	159,717
Selling and administrative expenses	<u>43,523</u>	<u>31,707</u>	<u>118,423</u>	<u>84,350</u>
Income from operations	42,091	27,156	109,844	75,367
Interest income	1,363	1,305	3,366	3,516
Other expense	<u>(96)</u>	<u>(77)</u>	<u>(317)</u>	<u>(239)</u>
Income before income taxes	43,358	28,384	112,893	78,644
Income tax provision	<u>17,170</u>	<u>11,243</u>	<u>44,706</u>	<u>31,145</u>
Net income	<u>\$ 26,188</u>	<u>\$ 17,141</u>	<u>\$ 68,187</u>	<u>\$ 47,499</u>
Earnings per share				
Basic	<u>\$ 0.61</u>	<u>\$ 0.40</u>	<u>\$ 1.58</u>	<u>\$ 1.10</u>
Diluted	<u>\$ 0.59</u>	<u>\$ 0.39</u>	<u>\$ 1.55</u>	<u>\$ 1.09</u>
Weighted average number of common shares outstanding				
Basic	<u>43,150</u>	<u>43,076</u>	<u>43,104</u>	<u>43,086</u>
Diluted	<u>44,108</u>	<u>43,344</u>	<u>43,972</u>	<u>43,404</u>

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

CDW COMPUTER CENTERS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
(in thousands)
(unaudited)

	<u>Common Shares</u>		<u>Paid-in Capital</u>	<u>Retained Earnings</u>	<u>Unearned Compensation</u>	<u>Treasury Shares</u>		<u>Total Shareholders' Equity</u>
	<u>Shares</u>	<u>Amount</u>				<u>Shares</u>	<u>Amount</u>	
Balance at December 31, 1998	43,142	\$ 216	\$ 81,352	\$ 192,259	\$ (975)	100	\$ (2,089)	\$ 270,763
MPK Restricted Stock Plan forfeitures			(101)		101			-
Amortization of unearned compensation					288			288
Exercise of stock options	124	1	1,545					1,546
Tax benefit from stock option transactions			11,681					11,681
Net income				68,187				68,187
Balance at September 30, 1999	43,266	\$ 217	\$ 94,477	\$ 260,446	\$ (586)	100	\$ (2,089)	\$ 352,465

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

CDW COMPUTER CENTERS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)
(unaudited)

	Nine Months Ended September 30,	
	1999	1998
Cash flows from operating activities:		
Net income	\$ 68,187	\$ 47,499
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	5,143	3,429
Accretion of marketable securities, net	(2,184)	(2,033)
Allowance for doubtful accounts	1,115	935
Stock-based compensation expense	288	355
Legal fees assumed by majority shareholder, net of tax	-	673
Deferred income taxes	698	144
Tax benefit from stock option exercises	11,681	3,268
Changes in assets and liabilities:		
Accounts receivable	(91,507)	(49,554)
Miscellaneous receivables	(504)	(2,111)
Merchandise inventory	(22,750)	6,652
Prepaid expenses and other assets	191	(71)
Accounts payable	57,589	1,472
Accrued compensation	4,276	2,230
Accrued income taxes and other expenses	(4,092)	(4,363)
Accrued exit costs	(453)	(554)
Net cash provided by operating activities	27,678	7,971
Cash flows from investing activities:		
Purchases of available-for-sale securities	(66,703)	(24,810)
Redemptions of available-for-sale securities	44,292	21,250
Purchases of held-to-maturity securities	(50,020)	(64,945)
Redemptions of held-to-maturity securities	64,511	69,656
Investment in and advances to joint venture	(2,642)	-
Purchase of property and equipment	(6,596)	(12,426)
Net cash used in investing activities	(17,158)	(11,275)
Cash flows from financing activities:		
Proceeds from exercise of stock options	1,546	453
Repurchase of treasury shares	-	(2,089)
Net cash provided by / (used in) financing activities	1,546	(1,636)
Net increase / (decrease) in cash	12,066	(4,940)
Cash and cash equivalents - beginning of period	4,230	18,233
Cash and cash equivalents - end of period	\$ 16,296	\$ 13,293

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

CDW COMPUTER CENTERS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Description of Business

CDW Computer Centers, Inc. and its subsidiaries (collectively the "Company") are engaged in the distribution of brand name personal computers and related products primarily through direct marketing to end users within the United States. The Company's primary business is conducted from a combined sales, corporate office, warehouse and showroom facility located in Vernon Hills, Illinois. The Company also operates a sales office in Buffalo Grove, Illinois, a retail showroom in Chicago, Illinois and a government sales office in Chantilly, Virginia.

The Company extends credit to business, government and institutional customers under certain circumstances based upon the financial strength of the customer. Such customers are typically granted net 30 day credit terms. The balance of the Company's sales are made primarily through third-party credit cards and for cash-on-delivery.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in conformity with generally accepted accounting principles. Such principles were applied on a basis consistent with those reflected in the 1998 Annual Report on Form 10-K and documents incorporated therein as filed with the Securities and Exchange Commission. The accompanying financial data should be read in conjunction with the notes to consolidated financial statements contained in the 1998 Annual Report on Form 10-K and documents incorporated therein. In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting solely of normal recurring accruals) necessary to present fairly the financial position of the Company as of September 30, 1999 and December 31, 1998, the results of operations for the three and nine months ended September 30, 1999 and 1998, the cash flows for the nine months ended September 30, 1999 and 1998, and the changes in shareholders' equity for the nine months ended September 30, 1999. The unaudited condensed consolidated statements of income for such interim periods are not necessarily indicative of results for the full year.

Pervasiveness of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Additionally, such estimates and assumptions affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Earnings Per Share

A reconciliation of basic and diluted earnings per-share computations in accordance with Financial Accounting Standards No. 128 "Earnings Per Share" (SFAS 128) is included in Note 6 to the financial statements.

On April 20, 1999, the Board of Directors of the Company approved a two-for-one stock split to be effected in the form of a stock dividend payable on May 19, 1999 to all common shareholders of record at the close of business on May 5, 1999. All per share and related amounts contained in these financial statements and notes have been adjusted to reflect the stock split.

3. Marketable Securities

The amortized cost and estimated fair values of the Company's investments in marketable securities at September 30, 1999, were (in thousands):

Security Type	Estimated Fair Value	Gross Unrealized Holding		Amortized Cost
		Gains	(Losses)	
Available-for-sale:				
U.S. Government and Government Agency Securities	\$ 25,129	\$ -	\$ (19)	\$ 25,148
Total available-for-sale	25,129	-	(19)	25,148
Held to maturity:				
U.S. Government and Government Agency Securities	51,356	-	(58)	51,414
Total held-to-maturity	51,356	-	(58)	51,414
Total marketable securities	\$ 76,485	\$ -	\$ (77)	\$ 76,562

The Company's investments in securities held-to-maturity at September 30, 1999 were all due in one year or less by contractual maturity. Estimated fair values of marketable securities are based on quoted market prices.

4. Facilities & Exit Accrual

In July 1997, the Company relocated to its current facility in Vernon Hills and vacated its Buffalo Grove facility. The Company recorded a pre-tax non-recurring charge to operating results for exit costs in the first quarter of 1996. The exit costs consist primarily of the estimated cost to the Company of subleasing the vacated facility, including holding costs, the estimated costs of restoring the building to its original condition and certain asset write-offs resulting from the relocation.

The Company reopened the office portion of the Buffalo Grove facility during the fourth quarter of 1998 as a telemarketing facility. Accordingly, the Company records a proportionate share of the rent and other operating costs to selling and administrative expenses. The Company sublet the warehouse and showroom portions of the Buffalo Grove facility to a third party for the period beginning June 15, 1999, and continuing through December 31, 2003, the end of the lease term. The remaining portion of the rent not covered by the sublease or the amount recorded to selling and administrative expenses continues to be charged against the exit accrual. There is no assurance that the remaining exit liability of \$2.3 million at September 30, 1999, will be adequate to cover actual costs in the event the sublessee is unable or unwilling to complete the lease term.

During the nine months ended September 30, 1999, the Company charged approximately \$453,000 against the exit accrual in cash payments for rent, real estate taxes and maintenance of the facility, net of sub-lease payments received which totaled approximately \$187,000. During the comparable period in 1998, the

Company charged approximately \$554,000 against the exit accrual for similar costs.

On October 11, 1999 the Company entered into a lease agreement for two floors of office space totaling approximately 72,000 square feet in Chicago, Illinois. The Company plans to establish a sales office in the facility with the lease commencing for one floor on April 1, 2000, and for the second floor on September 1, 2000. The lease provides a ten year term, with certain expansion and renewal options. The Company plans to expend between \$8 million and \$10 million for computer and telecommunication equipment, furniture and improvements related to the facility. Minimum future rent payments for all the Company's lease obligations, including the new Chicago facility are as follows (in thousands):

<u>Years Ended December 31,</u>	<u>Amount</u>
2000	\$ 1,467
2001	1,925
2002	1,926
2003	1,958
2004	1,149
Thereafter	2,402
	<u>\$ 10,827</u>

5. *Financing Arrangements*

The Company has an aggregate \$50 million available pursuant to two \$25 million unsecured lines of credit with two financial institutions, one which expires in June 2000, at which time the Company intends to renew the line, and another which does not have a fixed expiration date. Borrowings under the first credit facility bear interest at the prime rate less 2 1/2%, LIBOR plus 1/2% or the federal funds rate plus 1/2%, as determined by the Company. Borrowings under the second credit facility bear interest at the prime rate less 2 1/2%, LIBOR plus .45% or the federal funds rate plus .45%, as determined by the Company. At September 30, 1999, there were no borrowings against either of the credit facilities.

The Company has entered into security agreements with certain financial institutions ("Flooring Companies") in order to facilitate the purchase of inventory from various suppliers under certain terms and conditions. The agreements allow for a maximum credit line of \$64.0 million collateralized by inventory purchases financed by the Flooring Companies. At September 30, 1999, all amounts owed the Flooring Companies are included in trade accounts payable.

6. *Earnings Per Share*

The Company had approximately 43,266,000 issued and 43,166,000 shares outstanding at September 30, 1999. The Company has also granted options to purchase common shares to the directors and coworkers of the Company under several stock option plans. These options have a dilutive effect on the calculation of earnings per share. The following is a reconciliation of the numerators and denominators of the basic and diluted earnings per share computations as required by SFAS 128.

	<u>Three Months Ended</u>		<u>Nine months Ended</u>	
	<u>September 30,</u>		<u>September 30,</u>	
	<u>1999</u>	<u>1998</u>	<u>1999</u>	<u>1998</u>
Basic earnings per share:				
Income available to				

common shareholders (numerator)	\$ 26,188	\$ 17,141	\$ 68,187	\$ 47,499
Weighted average common shares outstanding (denominator)	43,150	43,076	43,104	43,086
Basic earnings per share	<u>\$ 0.61</u>	<u>\$ 0.40</u>	<u>\$ 1.58</u>	<u>\$ 1.10</u>
Diluted earnings per share:				
Income available to common shareholders (numerator)	\$ 26,188	\$ 17,141	\$ 68,187	\$ 47,499
Weighted average common shares outstanding	43,150	43,076	43,104	43,086
Effect of dilutive securities:				
Options on common stock	958	268	868	318
Total common shares and dilutive securities (denominator)	44,108	43,344	43,972	43,404
Diluted earnings per share	<u>\$ 0.59</u>	<u>\$ 0.39</u>	<u>\$ 1.55</u>	<u>\$ 1.09</u>

7. Leasing Joint Venture

In April 1999, CDW Capital Corporation, a wholly-owned subsidiary of CDW, and First Portland Corporation (“FIRSTCORP”) formed CDW Leasing, L.L.C. (“CDW-L”), a 50/50 joint venture. CDW-L provides captive leasing services to CDW customers. FIRSTCORP is a full-service leasing organization that has provided third party leasing solutions to CDW customers for more than three years. Under the terms of an operating agreement, FIRSTCORP provides leasing management services to CDW-L, with net earnings of the venture allocated 50% to CDW and 50% to FIRSTCORP. CDW Capital Corporation contributed \$100,000 to the capital of CDW-L and has committed to loan up to \$10 million to CDW-L on a secured basis to fund new leases initiated by CDW-L. The investment in CDW-L is accounted for using the equity method. The investment and loan to CDW-L at September 30, 1999 is not material to the total assets of the Company and is included in Deferred Income Taxes and Other Assets on the consolidated Balance Sheets. In addition, the income recognized by the Company from its investment in CDW-L for the three and nine months ended September 30, 1999 were not material to the total income of the Company as reported on the consolidated Statements of Income.

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

The following discussion and analysis of the Company's financial condition and results of operations should be read in conjunction with the Company's unaudited condensed consolidated financial statements and the notes thereto included elsewhere herein.

Results Of Operations

The following table sets forth financial information derived from the Company's statements of income expressed as a percentage of net sales, and certain operating statistics.

Financial Information	Percentage of Net Sales			
	Three Months Ended September 30,		Nine months Ended September 30,	
	<u>1999</u>	<u>1998</u>	<u>1999</u>	<u>1998</u>
Net sales	100.0 %	100.0 %	100.0 %	100.0 %
Cost of sales	87.5	87.3	87.5	87.3
Gross profit	12.5	12.7	12.5	12.7
Selling and administrative expenses	6.4	6.9	6.5	6.7
Income from operations	6.1	5.8	6.0	6.0
Other income, net	0.2	0.3	0.2	0.3
Income before income taxes	6.3	6.1	6.2	6.3
Income tax provision	2.5	2.4	2.5	2.5
Net income	3.8 %	3.7 %	3.7 %	3.8 %

Operating Statistics	Three Months Ended September 30,		Nine months Ended September 30,	
	<u>1999</u>	<u>1998</u>	<u>1999</u>	<u>1998</u>
Number of invoices processed	770,356	595,015	2,127,800	1,730,674
Average invoice size	\$931	\$828	\$901	\$775
Number of account managers, end of period	744	625		
Customers serviced – commercial	126,000	107,000	233,000	205,000
% of sales to commercial customers	93.5%	89.0%	92.4%	87.2%
Annualized inventory turns	28	31	28	25

The following table presents net sales by product line as a percentage of total net sales. Product classifications are based upon internal product code classifications and are retroactively adjusted for the addition of new categories but not for changes in individual product categorization.

Analysis of Product Mix	Three Months Ended September 30,		Nine months Ended September 30,	
	1999	1998	1999	1998
Notebooks & Laptops	21.3 %	19.3 %	20.2 %	19.8 %
Desktop Computers	14.1	15.2	15.0	15.7
Software	13.0	13.7	13.3	13.6
Printers	11.1	12.7	11.4	12.7
Data Storage Devices	11.0	12.1	10.5	11.6
Network & Communication Products	9.8	9.9	9.6	9.3
Monitors & Video Products	7.1	7.6	7.2	7.9
Add-On Boards & Memory	4.7	3.7	4.6	4.0
Supplies	3.7	1.1	3.6	0.4
Input Devices	1.9	2.3	2.2	2.6
Multi-Media Devices	1.1	1.9	1.3	2.0
Other Accessories	1.2	0.5	1.1	0.4
Total	100.0 %	100.0 %	100.0 %	100.0 %

Three months ended September 30, 1999 compared to three months ended September 30, 1998

Net sales in the third quarter of 1999 increased 47.6% to a record \$683.0 million compared to \$462.7 million in the third quarter of 1998. The growth in net sales is primarily attributable to a higher concentration of commercial accounts, a higher level of sales per active account and increases in the average invoice size and number of invoices processed. Sales to commercial accounts, including business, government, educational and institutional customers, increased to 93.5% of net sales in the third quarter of 1999 from 89.0% in the third quarter of 1998. The number of active commercial customers increased 17.8% to 126,000 in the third quarter of 1999 from 107,000 in the third quarter of 1998. For the three months ended September 30, 1999, the average invoice size increased 12.4% to \$931 and the number of invoices processed increased 29.5% to over 770,000. Notebook computers continue to represent the largest component of the Company's product mix.

The average selling price of desktop and server CPU's decreased 1.3% and the average selling price of notebook CPU's declined 5.3% from the third quarter of 1998. The Company believes there may be future decreases in prices for personal computers and related products. Such decreases require the Company to sell more units in order to maintain or increase the level of sales. The Company's sales growth rate and operating results could be adversely affected by future manufacturer price reductions or if the Company's sales and marketing efforts fail to increase the level of unit sales. Sales of Compaq, Hewlett Packard, IBM, Microsoft and Toshiba products comprise a substantial portion of the Company's sales. The loss of any of these, or any other key vendors, could have an adverse effect on the Company's results from operations. The statement concerning future prices, sales and results from operations are forward looking statements that involve certain risks and uncertainties such as stated above.

The fastest growing product categories in terms of sales dollars and the respective growth rates in the third quarter of 1999 compared to the third quarter of 1998 were:

<u>Product Category</u>	<u>Growth Rate</u>
Add-On Boards & Memory	87.7%
Notebooks & Laptops	62.8%
Network and Communication Products	46.6%
Software	40.0%
Monitors & Video Products	36.8%

Demand for certain products and the growth of certain product categories, are driven by advances in technology and the development of new products and applications by the industry manufacturers, and acceptance of these new technologies and products by end-users. Any slowdown in the rate of technological advancement and new product development by industry manufacturers could have a material adverse effect on the Company's future sales growth.

Gross profit decreased as a percentage of net sales to 12.5% for the three months ended September 30, 1999, compared to 12.7% in the third quarter of 1998. The decrease in gross profit as a percentage of net sales is primarily the result of lower selling margins achieved on certain product lines and lower levels of vendor support programs. On a forward-looking basis, it is likely that the gross profit margin achieved will fluctuate from quarter to quarter and may be lower than the 12.5% achieved in the third quarter of 1999. The statement concerning future gross profit is a forward looking statement that involves certain risks and uncertainties such as the continued participation by vendors in inventory price protection and rebate programs, pricing strategies, product mix, market conditions and other factors which could result in a fluctuation of gross margins below recent experience. Certain manufacturers may make additional changes that limit the amount of price protection for which the Company is eligible. Such changes could have a negative impact on gross margin in future periods. Vendor rebate programs are at the discretion of the vendor and many of these programs are dependent on achieving certain goals and objectives. Accordingly, there is no certainty that such programs will continue at their current levels or that the established goals and objectives will be attained.

Selling and administrative expenses, which include net advertising expense, other selling administrative expenses and the executive incentive bonus pool declined to 6.4% of net sales in the three months ended September 30, 1999 from 6.9% in the same period of 1998.

Net advertising expense decreased as a percentage of net sales to 0.52% from 0.85% for the three months ended September 30, 1999 and 1998, respectively. Gross advertising expense increased \$2.6 million, while decreasing as a percentage of net sales in the third quarter to 2.4% from 3.0% in the third quarter of 1998. The Company decreased catalog circulation versus the prior year while increasing the number of national advertising pages and expanding its spending on its corporate branding campaign and other direct marketing activities. Based upon the Company's planned marketing initiatives, future levels of gross advertising expense as a percentage of net sales are likely to be relatively consistent with or higher than the level achieved in the third quarter of 1999. Cooperative advertising reimbursements decreased as a percentage of net sales to 1.9% of net sales in the third quarter of 1999 from 2.1% in the third quarter of 1998. The cooperative advertising reimbursement rate may fluctuate in future quarters depending on the level of vendor participation achieved, changes in vendor programs and collection experience. The statements concerning future advertising expense and cooperative advertising reimbursements are forward looking statements that involve certain risks and uncertainties including the ability to identify and implement cost effective incremental advertising and marketing programs as well as the continued participation of vendors in the cooperative advertising reimbursement program.

Other selling and administrative costs decreased to 5.5% of net sales in the third quarter of 1999 from 5.7% in the same period of 1998. Increases in coworker productivity offset increased payroll and associated costs related to expansion of the sales force. As of September 30, 1999, there were 744 sales account managers, an increase of 19.0% from 625 sales account managers as of September 30, 1998. Approximately

76% of the 744 sales account managers had fewer than 24 months experience and 56% had fewer than 12 months, as compared to 72% and 56% at September 30, 1998. The Company plans to increase the number of sales account managers to approximately 800 by December 31, 1999 and to within the range of 1,050 to 1,150 by December 31, 2000.

In October 1999, the Company agreed to lease approximately 72,000 square feet of office space in Chicago, Illinois as an additional sales office (see Working Capital and Footnote 4 to the financial statements). Average annual future minimum lease expense for the new sales office is approximately \$1.1 million per year. As a result of the expansion of the sales force and the new sales office the Company's selling and administrative costs may increase as a percentage of net sales in future periods.

The executive incentive bonus pool increased to \$2.5 million in the third quarter of 1999 from \$1.0 million in the third quarter of 1998. For 1999, the Compensation and Stock Option Committee established the bonus pool at 15% of the increase in operating income over the prior year.

Interest income, net of other expenses, increased slightly to \$1.3 million in the third quarter of 1999 compared to \$1.2 million in the third quarter of 1998.

The effective income tax rate, expressed as a percentage of income before income taxes, was 39.6% for the three months ended September 30, 1999 and 1998.

Net income for the three months ended September 30, 1999, was \$26.2 million, a 52.8% increase over \$17.1 million for the three months ended September 30, 1998. Diluted earnings per share was \$0.59 for the three months ended September 30, 1999 and \$0.39 in the same period of 1998, an increase of 51.3%. All per share amounts have been adjusted to reflect the two-for-one stock split effected in the form of a stock dividend paid on May 19, 1999.

Nine months ended September 30, 1999 compared to nine months ended September 30, 1998

Net sales in the first nine months of 1999 increased 44.9% to a record \$1.820 billion compared to \$1.256 billion in the first nine months of 1998. The growth in net sales is primarily attributable to a higher concentration of commercial accounts, a higher level of sales per active account and increases in the average invoice size and number of invoices processed. Sales to commercial accounts, including business, government, educational and institutional customers, increased to 92.4% of net sales in the first nine months of 1999 from 87.2% in the first nine months of 1998. The number of active commercial customers increased 13.7% to 233,000 in the first nine months of 1999 from 205,000 in the first nine months of 1998. For the nine months ended September 30, 1999, the average invoice size increased 16.3% to \$901 and the number of invoices processed increased 23.0% to over 2.1 million. Notebook computers continue to represent the largest component of the Company's product mix.

The average selling price of desktop and server CPU's increased 4.4% and the average selling price of notebook CPU's declined 4.1% from the first nine months of 1998. The Company believes there may be future decreases in prices for personal computers and related products. Such decreases require the Company to sell more units in order to maintain or increase the level of sales. The Company's sales growth rate and operating results could be adversely affected by future manufacturer price reductions or if the Company's sales and marketing efforts fail to increase the level of unit sales. Sales of Compaq, Hewlett Packard, IBM, Microsoft and Toshiba products comprise a substantial portion of the Company's sales. The loss of any of these, or any other key vendors, could have an adverse effect on the Company's results from operations. The statement concerning future prices, sales and results from operations are forward looking statements that involve certain risks and uncertainties such as stated above.

The fastest growing product categories in terms of sales dollars and the respective growth rates in the nine months ended September 30, 1999 compared to the nine months ended September 30, 1998 were:

<u>Product Category</u>	<u>Growth Rate</u>
Add-On Boards & Memory	66.9%
Network & Communication Products	48.9%
Notebooks & Laptops	48.3%
Software	41.5%
Desktop Computers	38.3%

Demand for certain products and the growth of certain product categories, are driven by advances in technology and the development of new products and applications by the industry manufacturers, and acceptance of these new technologies and products by end-users. Any slowdown in the rate of technological advancement and new product development by industry manufacturers could have a material adverse effect on the Company's future sales growth.

Gross profit decreased as a percentage of net sales to 12.5% for the nine months ended September 30, 1999, compared to 12.7% in the first nine months of 1998. The decrease in gross profit as a percentage of net sales is primarily the result of lower selling margins achieved on certain product lines and lower levels of vendor support programs. On a forward-looking basis, it is likely that the gross profit margin achieved will fluctuate from quarter to quarter and may be lower than the 12.5% achieved in the first nine months of 1999. The statement concerning future gross profit is a forward looking statement that involves certain risks and uncertainties such as the continued participation by vendors in inventory price protection and rebate programs, pricing strategies, product mix, market conditions and other factors which could result in a fluctuation of gross margins below recent experience. Certain manufacturers may make additional changes that limit the amount of price protection for which the Company is eligible. Such changes could have a negative impact on gross margin in future periods. Vendor rebate programs are at the discretion of the vendor and many of these programs are dependent on achieving certain goals and objectives. Accordingly, there is no certainty that such programs will continue at their current levels or that the established goals and objectives will be attained.

Selling and administrative expenses, which include net advertising expense, other selling administrative expenses and the executive incentive bonus pool declined to 6.5% of net sales in the nine months ended September 30, 1999 from 6.7% for the same period of 1998.

Net advertising expense decreased as a percentage of net sales to 0.62% from 0.75% for the nine months ended September 30, 1999 and 1998, respectively. Gross advertising expense increased \$9.6 million while decreasing as a percentage of net sales in the first nine months to 2.6% from 3.1% in the same period of 1998. The Company decreased catalog circulation and the number of national advertising pages versus the prior year, while expanding its spending on its corporate branding campaign and other direct marketing activities. Based upon the Company's planned marketing initiatives, future levels of gross advertising expense as a percentage of net sales are likely to be relatively consistent with or higher than the level achieved in the first nine months of 1999. Cooperative advertising reimbursements as a percentage of net sales declined to 2.0% of net sales in the first nine months of 1999 from 2.3% for the nine months ended September 30, 1998. The cooperative advertising reimbursement rate may fluctuate in future quarters depending on the level of vendor participation achieved, changes in vendor programs and collection experience. The statements concerning future advertising expense and cooperative advertising reimbursements are forward looking statements that involve certain risks and uncertainties including the ability to identify and implement cost effective incremental advertising and marketing programs as well as the continued participation of vendors in the cooperative advertising reimbursement program.

Other selling and administrative costs decreased to 5.6% of net sales in the first nine months of 1999 from 5.7% in the same period of 1998. Increases in coworker productivity offset increased payroll and associated costs related to expansion of the sales force.

In October 1999, the Company agreed to lease approximately 72,000 square feet of office space in Chicago, Illinois as an additional sales office (see Working Capital and Footnote 4 to the financial statements). Average annual future minimum lease expense for the new sales office is approximately \$1.1 million per year. As a result of the expansion of the sales force and the new sales office the Company's selling and administrative costs may increase as a percentage of net sales in future periods.

The executive incentive bonus pool increased to \$5.7 million in the first nine months of 1999 from \$2.2 million in the first nine months of 1998. For 1999, the Compensation and Stock Option Committee established the bonus pool at 15% of the increase in operating income over the prior year.

Interest income, net of other expenses, decreased to \$3.0 million in the first nine months of 1999 compared to \$3.3 million in the first nine months of 1998.

The effective income tax rate, expressed as a percentage of income before income taxes, was 39.6% for the nine months ended September 30, 1999 and 1998.

Net income for the nine months ended September 30, 1999, was \$68.2 million, a 43.6% increase over \$47.5 million for the nine months ended September 30, 1998. Diluted earnings per share was \$1.55 for the nine months ended September 30, 1999, and \$1.09 for the same period of 1998, an increase of 42.2%. All per share amounts have been adjusted to reflect the two-for-one stock split effected in the form of a stock dividend paid on May 19, 1999.

Liquidity and Capital Resources

Working Capital

The Company has historically financed its operations and capital expenditures primarily through cash flow from operations, short-term borrowings and public offerings of common stock.

At September 30, 1999, the Company had cash, cash equivalents and marketable securities of \$92.8 million and working capital of \$306.8 million, representing an increase of \$22.2 million in cash, cash equivalents and marketable securities and an increase of \$78.1 million in working capital from December 31, 1998.

The Company has an aggregate \$50 million available pursuant to two \$25 million unsecured lines of credit with two financial institutions, one which expires in June 2000, at which time the Company intends to renew the line, and another which does not have a fixed expiration date. Borrowings under the first credit facility bear interest at the prime rate less 2 1/2%, LIBOR plus 1/2% or the federal funds rate plus 1/2%, as determined by the Company. Borrowings under the second credit facility bear interest at the prime rate less 2 1/2%, LIBOR plus .45% or the federal funds rate plus .45%, as determined by the Company. At September 30, 1999, there were no borrowings against either of the credit facilities.

The Company plans to expend between \$8 million and \$10 million during the next twelve months for computer and telecommunication equipment, furniture and improvements related to the new sales office in Chicago, Illinois.

The Company's current primary and anticipated use of cash is to fund future growth in working capital and capital expenditures. The Company believes that the funds held in cash, cash equivalents and marketable securities, and funds available under the credit facilities will be sufficient to fund the Company's working capital and cash requirements at least through September 30, 2000.

Cash flows for the nine months ended September 30, 1999

Net cash provided by operating activities for the nine months ended September 30, 1999, was \$27.7 million. The primary factors that historically affect the Company's cash flows from operations are accounts receivable, merchandise inventory and accounts payable. The increase in accounts receivable resulted from increased sales volume and an increase in the percentage of net sales generated from commercial accounts with open credit terms to 69.5% for the nine months ended September 30, 1999 from 61.9% for the same period of 1998. The accounts receivable days sales outstanding at September 30, 1999 was 32.7 as compared with 29.0 at December 31, 1998. Inventory increased during the period in response to increased sales volume. Annualized inventory turnover increased to approximately 28 times for the nine months ended September 30, 1999 from 25 for the nine months ended September 30, 1998. The increase in accounts payable reflects timing of payments to vendors at the end of the respective periods as well as the increase in inventory levels during the year.

Cash provided by operating activities for the nine months ended September 30, 1999, was positively impacted by a \$11.7 million tax benefit recorded to paid-in-capital, relating to the exercise of shares pursuant to the MPK Stock Option Plan and the CDW Incentive Stock Option Plan.

Net cash used in investing activities for the nine months ended September 30, 1999, was \$17.2 million, including approximately \$7.0 million used for capital expenditures. The capital expenditures made by the Company were primarily related to the purchase of machinery and equipment for the Vernon Hills facility.

Year 2000 Readiness Disclosure

General

The Year 2000 Issue ("Y2K") is the result of computer programs being written using two digits rather than four to define the applicable year. Any of the Company's computer programs that have date-sensitive software may recognize a date using "00" as the year 1900 rather than 2000. This could result in a system failure or miscalculations causing disruptions of operations, including, among other things, a temporary inability to process transactions, receive or ship products, send invoices, or engage in similar normal business activities.

The Company has established a Y2K project designed to make all its hardware and software systems Y2K compliant by December 31, 1999.

Project

CDW's Y2K project consists of two components, internal and external. The internal section has been divided into five steps:

1. Awareness – Awareness includes evaluating industry best practices, generating management and employee awareness, establishing communications methods and establishing the project team.
2. Assessment – This phase includes hardware and software compliance assessment, establishment of the size and scope of the project, establishment of a project timeline, priorities, budgeting and allocation of resources.
3. Renovation – Renovation consists of establishing a detailed implementation plan, the design of new systems and system corrections, writing of system code and software and hardware testing.
4. Validation – Validation includes testing new systems and system corrections to ensure they will function properly in operation.
5. Implementation – Final certification of the new and corrected systems, implementation of the systems and

monitoring to ensure they continue to function.

Substantially all phases of the project as they relate to internal systems were completed as of March 31, 1999. The Company plans to focus the majority of its efforts for the remainder of 1999 on the external portion of the project. The Company will also test all its internal systems a second time to ensure those systems are properly converted.

The external portion of the project focuses on assessing the Y2K readiness of product and service vendors and its potential impact on the Company's operations. The Company distributed questionnaires to these vendors for this purpose. To date the Company has received responses from over 30% of the vendors contacted, each indicating they were not anticipating business disruption due to Y2K. The Company is working to obtain responses from all significant vendors and work to resolve identifiable issues, if any, to minimize potential business interruptions. This portion of the project is expected to be completed prior to December 31, 1999.

Costs

The Company originally estimated that total costs for the Y2K project, through December 31, 1999, would range between \$750,000 and \$1 million. Actual costs incurred to date for the Y2K project have been lower than originally estimated. As such, the Company now estimates that total costs for the project will range between \$500,000 and \$650,000. As of September 30, 1999 the Company has incurred, and recorded as operating expenses, approximately \$370,000 in costs related to the project, of which approximately \$130,000 was incurred during the nine months ended September 30, 1999. The Company's expenditures to date consist primarily of internal payroll costs related to the assessment and correction of internal systems. Of the estimated remaining costs of \$130,000 to \$280,000, approximately 75% relate to the cost of assessing and communicating with vendors and 25% relate to the correction of internal systems.

Risks

The failure to correct a material Y2K problem could result in an interruption in, or a failure of, certain normal business activities or operations. Such failures could materially and adversely affect the Company's results of operations and financial condition. Due to the general uncertainty inherent in the Y2K problem, resulting in part from the uncertainty of the Y2K readiness of third-party suppliers, the Company is unable to determine at this time whether the consequences of Y2K failures will have a material impact on the Company's results of operations and financial condition. The Company's Y2K project is expected to significantly reduce the Company's level of uncertainty about the Y2K problem and, in particular, about the Y2K compliance and readiness of its material vendors. The Company believes that, with the completion of the project as scheduled, the possibility of significant interruptions of normal operations should be minimized.

The statements concerning future impact of the Y2K issue are forward looking statements that involve certain risks and uncertainties, such as the inability to receive products on a timely basis from vendors, ship products to customers, receive payments from customers and other factors which could have a material impact on the Company's results from operations. Certain vendors may fail to adequately prepare their information systems or the Company's own Y2K project may not correct all Y2K issues. Accordingly, there is no certainty that the Company's vendors will complete their Y2K projects prior to December 31, 1999, which if not completed could affect the operations of the Company as noted above.

Certain statements included in Management's Discussion and Analysis of Financial Condition and Results of Operations concerning the Company's sales growth, gross profit as a percentage of sales, advertising expense, cooperative advertising reimbursements and the potential impact on operations of the Y2K issue are forward-looking statements that involve certain risks and uncertainties, as specified herein.

Part II Other Information

Item 1. Legal Proceedings

The Company is currently not a party to any material legal proceedings.

Item 5. Other information

On November 2, 1999 pursuant to unanimous consent of the Company's Board of Directors, the Company expanded its Board of Directors to seven members from five, and elected Casey Cowell and Donald P. Jacobs to fill the newly created positions, effective immediately. Each new member's term will run until the 2000 annual meeting at which time all directors' terms expire.

Mr. Cowell co-founded U.S. Robotics, one of the world's leading suppliers of data communications products and systems. He served as Chairman and CEO of U. S. Robotics from inception until its acquisition by 3Com in June 1997. Mr. Cowell is chairman and principal owner of Durandal, Inc., a holding company for several diversified private companies, and serves on the board of directors of 3Com. A graduate of the University of Chicago, Mr. Cowell is a member of the board of trustees for the University of Chicago and the Illinois Institute of Technology.

Dr. Donald P. Jacobs is the dean of the J.L. Kellogg Graduate School of Management and has been a member of the Kellogg faculty since joining the school in 1957. Dr. Jacobs serves as chairman of the public review board of Arthur Andersen and serves on the board of directors of several corporations, including Commonwealth Edison, Hartmarx and Terex. Dr. Jacobs received his Bachelor of Arts degree from Roosevelt University, Master of Arts degree and doctorate in economics from Columbia University and numerous honorary degrees from prestigious national and international universities.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits:

- | | |
|---------|--|
| 10 (zz) | Lease Agreement Dated October 11, 1999 between the Company as Lessee and Solano Associates as Lessor |
| 27 (a) | Financial Data Schedule (for the three months ended September 30, 1999) |

(b) Reports on Form 8-K:

There were no reports on Form 8-K filed for the three months ended September 30, 1999.

SIGNATURES

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

CDW Computer Centers, Inc.
(Registrant)

Date	<u>November 15, 1999</u>	<u>/s/ Harry J. Harczak, Jr.</u> Harry J. Harczak, Jr. Chief Financial Officer & Treasurer
Date	<u>November 15, 1999</u>	<u>/s/ Sandra M. Rouhselang</u> Sandra M. Rouhselang Controller

Index to Exhibits

- 10 (zz) Lease Agreement Dated October 11, 1999 between the Company as Lessee and Solano Associates as Lessor
- 27 Financial Data Schedule