



Entertainment, Inc. ("Hastings" or the "Company") maintains its principal executive offices in this District at 3601 Plains Blvd., Suite #1, Amarillo, Texas, 79102.

3. In connection with the acts, conduct and other wrongs complained of herein, defendants, directly or indirectly, used the means and instrumentalities of interstate commerce, the United States mails, and the facilities of a national securities market.

### THE PARTIES

4. Plaintiff Mitchell S. Warstadt purchased 50 shares of Hastings common stock during the Class Period, as detailed in the attached Certification, and suffered damages as a result of defendants' violations of the federal securities laws pled herein.

5. Defendant Hastings is a multimedia entertainment retailer that combines the sale of books, music, software, periodicals, videocassettes and DVDs with the rental of videocassettes, video games and DVDs in a superstore format. The Company also operates a multimedia entertainment e-commerce Web site offering a selection of books, music, software, videocassettes, video games and DVDs.

6. Defendant John Marmaduke ("Marmaduke") is the Chief Executive Officer, President, and Chairman of the Board of Directors ("the Board") of Hastings. As Chief Executive Officer, President and Chairman of the Board, Marmaduke was directly involved in Hastings' fraudulent revenue recognition practices during the Class Period.

7. (a) Until September 23, 1999, defendant Dennis McGill ("McGill"), served as Vice President of Finance and Chief Financial Officer ("CFO") of Hastings. As Vice President of Finance and CFO, McGill signed Hastings' Form 10-Qs for fiscal year 1998 and the first and second quarters of fiscal 1999, which the Company filed with the SEC. On September 23, 1999,

Hastings announced that McGill had resigned and on November 16, 1999, Hastings announced that defendant Thomas D. Nugent had replaced him as President of Finance and CFO.

(b) Because of defendant McGill's position as Vice President of Finance and Chief Financial Officer, he was directly involved in Hastings' fraudulent revenue recognition practices during the Class Period and, being responsible for the preparation of the Company's financial statements, falsely endorsed as accurate Hastings' financial statements reported in the Company's Registration Statement and Form 10-Qs filed with the SEC during the Class Period. As Vice President of Finance and Chief Financial Officer, he reviewed and improperly authorized the public issuance of Hastings' financial statements which were not prepared in accordance with generally accepted accounting principles ("GAAP").

8. (a) Defendant Thomas Nugent ("Nugent"), served as President of Finance and CFO of Hastings after November 16, 1999. As President of Finance and CFO, Nugent signed Hastings' Form 10-Q for the third quarter of 1999, which was filed with the SEC.

(b) Because of defendant Nugent's position of President of Finance and CFO, he was directly involved in Hastings' fraudulent revenue recognition practices and being responsible for the preparation of the Company's financial statements, falsely endorsed as accurate Hastings' financial statements reported in the Company's Form 10-Q for the third quarter of 1999. As President of Finance and Chief Financial Officer, he reviewed and improperly authorized the public issuance of Hastings' financial statements which were not prepared in accordance with GAAP.

9. Defendants Marmaduke, McGill, and Nugent (collectively, the "Individual Defendants") were aware of the false and misleading SEC filings, press releases, and other

statements complained of herein at the time they were issued and knew they contained false and misleading statements when made.

### **CLASS ALLEGATIONS**

10. Plaintiff brings this action on his own behalf and as a class action pursuant to Rule 23(a) and Rule 23(b)(3) of the Federal Rules of Civil Procedure on behalf of a class (the "Class") of all persons who purchased Hastings common stock from June 12, 1998 through March 7, 2000, inclusive (the "Class Period"). Excluded from the Class are defendants herein, members of the family of each of the Individual Defendants, officers and directors of the Company, parents, subsidiaries and affiliates of the corporate defendant, and the legal representatives, heirs, successors and assigns of any such excluded party.

11. Hastings' common stock was actively traded on the NASDAQ National Market system, which is an efficient market, throughout the Class Period. The members of the Class, as purchasers on that market, are so numerous that joinder of all members is impracticable. While the exact number of Class members can only be determined by appropriate discovery, plaintiff believes that class members number in the hundreds. As of December 14, 1999, Hastings had more than 11.6 million shares of common stock issued and outstanding.

12. Plaintiff's claims are typical of the claims of the members of the Class. Plaintiff and all other members of the Class sustained damages as a result of defendants' wrongful conduct complained of herein.

13. Plaintiff will fairly and adequately protect the interests of the other members of the Class and has retained counsel competent and experienced in class and securities litigation.

14. A class action is superior to other available methods for the fair and efficient

adjudication of this controversy. Because the damages suffered by individual class members may be relatively small, the expense and burden of individual litigation make it virtually impossible for the class members individually to seek redress for the wrongful conduct alleged herein.

15. Common questions of law and fact exist as to all members of the Class and predominate over any questions affecting solely individual members of the Class. Among the questions of law and fact common to the Class are:

- a. whether the federal securities laws were violated by defendants' acts as alleged herein;
- b. whether defendants misstated the financial results of the Company during the Class Period, in direct contravention of GAAP;
- c. whether defendants acted intentionally or recklessly in misrepresenting material facts;
- d. whether the market price of Hastings common stock during the Class Period was artificially inflated due to the material misrepresentations complained of herein; and
- e. whether the members of the Class have sustained damages and, if so, the appropriate measure thereof;

16. Plaintiff knows of no difficulty that will be encountered in the management of this litigation that would preclude its maintenance as a class action.

17. The names and addresses of the record owners of Hastings common stock purchased during the Class Period are available from the Company's transfer agent(s). Notice can be provided to such record owners via first class mail using techniques and a form of notice similar to those customarily used in class actions.

#### **FACTUAL ALLEGATIONS**

18. On June 12, 1998, the first day of the Class Period, the Company announced the

commencement of an initial public offering of 3,377,333 shares of common stock pursuant to a registration statement and prospectus (the "registration statement") filed by defendants with the SEC, and signed by defendants Marmaduke and McGill. Shortly thereafter, on June 18, 1998, the Company announced the "closing" of its initial public offering priced at \$13.00 per share -- raising net proceeds of approximately \$39.8 million.

19. In the registration statement, Hastings reported its financial results for its fiscal years 1997 and 1998, ended January 31. With respect to these fiscal years reported in the registration statement, the Company adopted and incorporated the opinion of its independent outside auditor that these financial statements "present fairly, in all material respect, the financial position of [Hastings] . . . in conformity with generally accepted accounting principles." In reality, the reported financial results for fiscal years 1997 and 1998, as reported in the registration statement, were materially false and misleading as defendants had improperly entered merchandise receipts into the inventory control system which materially understated the Company's cost of revenues and overstated its gross profit and net income in violation of GAAP.

20. Shortly thereafter, on July 7, 1998, the Company issued a press release entitled, **"Hastings Entertainment Reports Fiscal 1998 First Quarter Financial Results."** In the press release, the Company announced that in the first quarter of fiscal year 1998, net income was up 30.7% to \$1,202,000, and total revenues were up 14% to \$89,387,000. Defendant Marmaduke commented on the results by stating: "Our company achieved a solid 30% increase in operating profitability in the first quarter of fiscal 1998."

21. On July 27, 1998, Hastings filed with the SEC its report on Form 10-Q for the first quarter of fiscal 1998, ended April 30, 1998. The first quarter fiscal 1998 Form 10-Q was signed

by defendant McGill and repeated the financial results reported in the Company's press release issued on July 7, 1998. The Form 10-Q also contained defendants' assurance that the financial statements contained therein

have been prepared in accordance with generally accepted accounting principles for interim financial information and with instructions in Form 10-Q and Article 10 of Regulation S-X . . . All adjustments, consisting only of normal recurring adjustments, have been made which, in the opinion of management, are necessary for a fair presentation of the results of the interim periods

These reported financial results, however, were materially false and misleading, as defendants improperly entered merchandise receipts into the inventory control system which materially understated the Company's cost of revenues and overstated its gross profit and net income in violation of GAAP.

22. On August 25, 1998, the Company issued a press release entitled, "**Hastings Entertainment Net Income Up 41% on 12% Sales Gain.**" In the press release, the Company announced that net income in the second quarter of fiscal 1998, ended July 31, 1998, had increased 40.6% to \$1,798,000, and earnings per share had increased by 20%, to \$0.18 per share.

23. On September 12, 1998, Hastings filed with the SEC its report on Form 10-Q for the second quarter of fiscal 1998, ended July 31, 1998. The second quarter fiscal 1998 Form 10-Q was signed by defendant McGill and repeated the financial results reported in the Company's press release issued on August 25, 1998. The Form 10-Q also contained defendants' assurance that the financial statements contained therein

have been prepared in accordance with generally accepted accounting principles for interim financial information and with instructions in Form 10-Q and Article 10 of Regulation S-X . . . All adjustments, consisting only of normal recurring adjustments, have been made which, in the opinion of management, are necessary for a fair presentation of the results of the interim periods

These reported financial results, however, were materially false and misleading, as defendants improperly entered merchandise receipts into the inventory control system which materially understated the Company's cost of revenues and overstated its gross profit and net income in violation of GAAP.

24. On November 18, 1998, the Company issued a press release entitled, "**Hastings Posts Eleven Fold Increase In Third Quarter 1998 EPS.**" In the press release, the Company announced that earnings per share increased for the third quarter of fiscal 1998 to \$0.11 for the same period -- a 1000% increase in earnings per share as compared to the prior year and that net income was \$1,318,000.

25. As a result of defendants' issuance of these false financial results, Hastings' stock price rose to a Class Period high of \$19.25 on November 30, 1998 -- an increase of over 50% from the start of the Class Period.

26. On December 14, 1998, Hastings filed with the SEC its report on Form 10-Q for the third quarter of fiscal 1998, ended October 31, 1998. The third quarter fiscal 1998 Form 10-Q was signed by defendant McGill and repeated the financial results reported in the Company's press release issued on November 18, 1998. The Form 10-Q also contained defendants' assurance that the financial statements contained therein

have been prepared in accordance with generally accepted accounting principles for interim financial information and with instructions in Form 10-Q and Article 10 of Regulation S-X . . . All adjustments, consisting only of normal recurring adjustments, have been made which, in the opinion of management, are necessary for a fair presentation of the results of the interim periods

These reported financial results, however, were materially false and misleading, as defendants improperly entered merchandise receipts into the inventory control system which materially

understated the Company's cost of revenues and overstated its gross profit and net income in violation of GAAP.

27. On January 14, 1999, the Company issued a press release entitled, "**Hastings Holiday Revenues Increase 10.6%; Comp-Store Revenues Exceed Expectations.**" In the press release, the Company announced "record revenues" for the five-week Christmas holiday period ended January 2, 1999, reporting that revenues over this period had increased 10.6%.

28. As a result of the defendants' continued reporting of false financial results, Hastings' stock price continued to trade during the month of January 1999 at artificially inflated prices between \$13 and \$14 per share.

29. On March 16, 1999, the Company issued a press release entitled, "**Hastings Entertainment Reports Fiscal Full Year and Fourth Quarter Results.**" In the press release, the Company announced "record" fiscal 1998 revenues of \$398.7 million, an increase of over 11% compared to the prior fiscal year and before the non-recurring charges, net income was up 15.0% to \$6.7 million. Commenting on the "record" 1998 financial results, defendant Marmaduke stated:

Fiscal 1998 was a milestone year for Hastings as we successfully completed our initial public offering in June, increased our superstore expansion program, launched our e-commerce internet site, and finalized our direct revenue-sharing agreements for video rentals with the major studios [].

Store-level and general and administrative expenses were carefully controlled, enabling us to offset slightly higher cost of product to increase the year's operational margins by more than 50 basis points over fiscal 1997 []. We opened 12 new stores on schedule during the year and expect to add 17-20 stores during fiscal 1999.

Fourth quarter results included record revenues for the 1998 Christmas season that exceeded our expectations, especially since we were comparing against

an exceptionally strong 1997 Christmas season []. Sales in our book, music, video, periodical and software departments continued to grow as customers in our small to medium-sized markets appreciated the wide range of entertainment products that our superstores offer. Our comparable-stores sales gain of 2.3% for the fourth quarter was meaningful since we were comparing against an exceptionally strong 11.0% gain in the 1997 fourth quarter. Comparable-store sales for the full year were up 5.5%.

30. On April 30, 1999, Hastings filed with the SEC its report on Form 10-K for fiscal year 1998, ended January 31, 1999. The 1998 Form 10-K was signed by defendants Marmaduke and McGill, and repeated the Company's "record" fourth quarter 1998 and year-end financial results reported in the Company's press release issued on March 16, 1999. The Company also incorporated in the Form 10-K the opinion of its independent outside auditor that these financial statements "present fairly, in all material respect, the financial position of [Hastings] . . . in conformity with generally accepted accounting principles." The year-end and fourth quarter reported results, however, were materially false and misleading, as defendants improperly entered merchandise receipts into the inventory control system which materially understated the Company's cost of revenues and gross profit and net income in violation of GAAP.

31. As a result of defendants' continued issuance of false financial results, Hastings' stock price rose to over \$15 per share on April 30, 1999 and to over \$16 per share by the next trading day.

32. On May 19, 1999, the Company issued a press release entitled "**Hastings Entertainment First Quarter Net Income Jumps 41% on 12.5% Revenue Gain; Comp-Stores Sales up 5.5%.**" In the press release, the Company announced that for the first quarter of fiscal 1999, ended April 30, 1999, net income increased 41.8% to \$1,705,000, revenues increased 12.5% and comparable-store sales increased 5.5%. Commenting on the results,

defendant Marmaduke stated:

Our first quarter results exhibited revenue growth in each of our major sales and rental categories with solid improvement in our gross margin performance []. Our retailing concept of providing a wide range of multimedia home entertainment products to small to-medium sized communities is unique, and it continues to allow Hastings to meet its growth goals while increasing profitability.

33. On June 14, 1999, Hastings filed with the SEC its report on Form 10-Q for the first quarter of fiscal 1999, ended May 19, 1999. The first quarter fiscal 1999 Form 10-Q was signed by defendant McGill and repeated the financial results reported in the Company's press release issued on May 19, 1999. The Form 10-Q also contained defendants' assurance that the financial statements contained therein

have been prepared in accordance with generally accepted accounting principles for interim financial information and with instructions in Form 10-Q and Article 10 of Regulation S-X . . . All adjustments, consisting only of normal recurring adjustments, have been made which, in the opinion of management, are necessary for a fair presentation of the results of the interim periods

These reported financial results, however, were materially false and misleading, as defendants improperly entered merchandise receipts into the inventory control system which materially understated the Company's cost of revenues and overstated its gross profit and net income in violation of GAAP.

34. On August 24, 1999, the Company issued a press release entitled "**Hastings Entertainment 1999 Second Quarter Net Income Up 16.1%.**" In the press release, the Company announced that net income for the second quarter of fiscal year 1999 increased 16.1% to \$2,088,000 and total revenues rose 12.3%. Commenting on the results, defendant Marmaduke stated:

Even with the additional costs associated with our expanded superstore opening program and the operation of our new e-commerce Web site, [www.gohastings.com](http://www.gohastings.com), our second quarter profitability was excellent []. We continue to deliver positive operating results as we grow our revenue base.

Over the years, Hastings has consistently recorded operating income in all four quarters of the year, which is not the case for many other companies in the entertainment retailing segment, many of whom usually live and die by their Christmas quarters. Hastings' unique multimedia retailing concept and our emphasis on operating in small to medium-sized markets provide a very solid base for growing future revenues and earnings.

35. On September 14, 1999, Hastings filed with the SEC its report on Form 10-Q for the second quarter of fiscal 1999, ended July 31, 1999. The second quarter fiscal 1999 Form 10-Q was signed by defendant McGill and repeated the financial results reported in the Company's press release issued on August 24, 1999. The Form 10-Q also contained defendants' assurance that the financial statements contained therein

have been prepared in accordance with generally accepted accounting principles for interim financial information and with instructions in Form 10-Q and Article 10 of Regulation S-X . . . All adjustments, consisting only of normal recurring adjustments, have been made which, in the opinion of management, are necessary for a fair presentation of the results of the interim periods

These financial results, however, were materially false and misleading, as defendants improperly entered merchandise receipts into the inventory control system which materially understated the Company's cost of revenues and overstated its gross profit and net income in violation of GAAP.

36. On September 23, 1999, Hastings issued a press release announcing the resignation of defendant McGill as the Company's CFO and Vice President of Finance. The press release quoted McGill as stating, "Hastings Entertainment is a strong company with a unique and outstanding business model. I continue to believe in Hastings' multi-media entertainment retailing concept, and anticipate excellent prospects for the company's long-term performance."

37. On November 23, 1999, the Company issued a press release entitled **“Hastings Entertainment 1999 Third Quarter Revenues Up 10.1%, EPS in Line With Adjusted Estimates.”** The press release announced that total revenues increased by \$9.2 million to \$100.9 million for the third quarter ended October 31, 1999 -- an increase of over 10% over the same period of the prior year. The company reported a net loss of \$2.3 million for the third quarter of fiscal 1999.

38. On December 14, 1999, Hastings filed with the SEC its report on Form 10-Q for the third quarter of fiscal 1999, ended October 31, 1999. The third quarter fiscal 1999 Form 10-Q was signed by defendant Nugent and repeated the financial results reported in the Company's press release issued on November 23, 1999. The Form 10-Q also contained defendants' assurance that the financial statements contained therein

have been prepared in accordance with generally accepted accounting principles for interim financial information and with instructions in Form 10-Q and Article 10 of Regulation S-X . . . All adjustments, consisting only of normal recurring adjustments, have been made which, in the opinion of management, are necessary for a fair presentation of the results of the interim periods

These reported financial results, however, were materially false and misleading, as defendants' improper entry of merchandise receipts into the inventory control system materially understated the Company's cost of revenues and overstated its gross profit in violation of GAAP.

39. On March 7, 2000, after the market closed, the Company issued a press release entitled **“Hastings Entertainment Announces Non-Cash Accounting Adjustment and Fourth Quarter Charges.”** In this press release, the Company announced that it would be required to restate its earnings **“for the first three quarters of fiscal 1999 and probably for the prior four fiscal years”** because the Company **“has determined that merchandise receipts**

were not properly entered into the inventory control system" for vendor deliveries and as a result "merchandise cost of revenue was understated." The Company also announced that it had "made appropriate changes to [its] internal accounting system to ensure that this problem does not recur" and the Company expected that those "changes are expected to have some impact on future operating margins." The Company disclosed that due to the improper entry of merchandise receipts it "believes the aggregate amount of the pre-tax effect of the restatement, after certain off-setting adjustments, could total \$23-\$27 million for all of the periods."

As such, this restatement nearly eliminates the Company's publicly reported net income for fiscal years 1995, 1996, 1997, 1998 and 1999 – as Hastings only reported approximately \$27.2 million in total net income for these periods.

40. On March 8, 2000, following these disclosures, the price of Hastings' stock dropped to its all-time low at \$3 1/16 per share on volume of 168,900 shares, reflecting a decline of approximately 84% below the stock's Class Period high, and over 23% below the prior day's closing price.

#### COUNT I

**Against All Defendants For Violations  
of Section 10(b) of the Exchange Act  
And Rule 10b-5 Promulgated Thereunder**

41. Plaintiff repeats and realleges each of the allegations set forth in the foregoing paragraphs.

42. Throughout the Class Period, defendants individually and in concert, directly and indirectly, by the use and means of instrumentalities of interstate commerce and/or of the mails,

engaged and participated in a continuous course of conduct to conceal adverse material information about Hastings, including its true financial results, as specified herein. Defendants employed devices, schemes, and artifices to defraud while in possession of material, adverse non-public information and engaged in acts, practices, and a course of conduct that included the making of, or participation in the making of, untrue statements of material facts. Specifically, defendants knew that the Company's reported financial results throughout the Class Period as filed with the SEC and disseminated to the investing public were materially overstated and were not presented in accordance with GAAP.

43. The Individual Defendants, as the directors and/or top executive officers of the Company, are liable as direct participants in the wrongs complained of herein. Through their positions of control and authority as officers and/or directors of the Company, the Individual Defendants were able to and did control the content of the public statements disseminated by Hastings. With knowledge of the falsity of the statements contained therein, the Individual Defendants caused the heretofore complained of public statements to contain misstatements and omissions of material facts as alleged herein.

44. Defendants acted with scienter throughout the Class Period, in that they had actual knowledge of the misrepresentations of material facts set forth herein. The Individual Defendants constituted the senior management of the Company, and were therefore directly responsible for the false and misleading statements disseminated to the public through press releases, news reports, and filings with the SEC.

45. Defendants' misrepresentations were intentional and concealed the Company's true operating condition from the investing public. Defendants engaged in this scheme to inflate the

Company's reported revenues and net income during the Class Period to create the illusion that Hastings was a successful, strong and profitable company.

46. As a result of these deceptive practices and false and misleading statements, the market price of Hastings common stock was artificially inflated during the Class Period. In ignorance of the false and misleading nature of the misrepresentations described above and the deceptive and manipulative devices employed by defendants, plaintiff and the other members of the Class, in reliance on either the integrity of the market or directly on the statements and reports of defendants, purchased Hastings common stock at artificially inflated prices.

47. Had plaintiff and the other members of the Class known of the material adverse information not disclosed by defendants, or been aware of the truth behind defendants' material misstatements, they would not have purchased Hastings common stock at artificially inflated prices.

48. By virtue of the foregoing, defendants have violated Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder.

## **COUNT II**

### **Against The Individual Defendants For Violations Under Section 20 Of The Exchange Act**

49. Plaintiff repeats and realleges each of the allegations set forth in the foregoing paragraphs.

50. Each of the Individual Defendants acted as a con-trolling person of the Company within the meaning of Section 20 of the Exchange Act during the Class Period. Specifically, defendant Marmaduke had the power and authority to cause the Company to engage in the

wrongful conduct complained of herein, by virtue of his position as Chief Executive Officer, President and Chairman of the Board. Further, defendant McGill had the power and authority to cause the Company to engage in the conduct alleged herein by virtue of his position as Vice President of Finance and Chief Financial Officer. Moreover, defendant Nugent had the power and authority to cause the Company to engage in the conduct alleged herein by virtue of his position as President of Finance and Chief Financial Officer. These defendants were each in a position to control or influence the contents of, or otherwise cause corrective disclosures to have been made in the Company's SEC filings, along with the Company's other public statements that contained materially false and misleading statements that were disseminated during the Class Period.

51. By reason of the wrongful conduct alleged herein, the Individual Defendants are liable pursuant to Section 20(a) of the Exchange Act. As a direct and proximate result of their wrongful conduct, plaintiff and the other members of the Class suffered damages in connection with their purchases of Hastings common stock during the Class Period.

#### **PRAYERS FOR RELIEF**

WHEREFORE, plaintiff, on behalf of himself and the other members of the Class, prays for judgment as follows:

1. Declaring this action to be a proper class action maintainable pursuant to Rule 23 of the Federal Rules of Civil Procedure and declaring plaintiff to be a proper Class representative;
2. Awarding plaintiff and the other members of the Class compensatory damages as a result of the wrongs alleged in Counts I and II of the Complaint;
3. Awarding plaintiff and the other members of the Class their costs and expenses in this litigation, including reasonable attorneys' fees and experts' fees and other costs and

disbursements; and

4. Awarding plaintiff and the other members of the Class such other and further relief as the Court may deem just and proper.


**JURY TRIAL DEMANDED**

Plaintiff demands a trial by jury of all issues so triable.

Dated: March 13, 2000

Respectfully submitted,

CLAXTON & HILL, PLLC

By: 

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