

# A

## Financial Statement Information

This appendix includes financial information for (1) **Best Buy**, (2) **Circuit City**, and (3) **Apple Computer**. This information is taken from their annual 10-K reports filed with the SEC. An **annual report** is a summary of a company's financial results for the year along with its current financial condition and future plans. This report is directed to external users of financial information, but it also affects the actions and decisions of internal users.

A company uses an annual report to showcase itself and its products. Many annual reports include attractive photos, diagrams, and illustrations related to the company. The primary objective of annual reports, however, is the *financial section*, which communicates much information about a company, with most data drawn from the accounting information system. The layout of an annual report's financial section is fairly established and typically includes the following:

- Letter to Shareholders
- Financial History and Highlights
- Management Discussion and Analysis
- Management's Report on Financial Statements and on Internal Controls
- Report of Independent Accountants (Auditor's Report) and on Internal Controls
- Financial Statements
- Notes to Financial Statements
- List of Directors and Officers

This appendix provides the financial statements for Best Buy (plus selected notes), Circuit City, and Apple Computer. The appendix is organized as follows:

- **Best Buy** A-2 through A-18
- **Circuit City** A-19 through A-23
- **Apple Computer** A-24 through A-28

Many assignments at the end of each chapter refer to information in this appendix. We encourage readers to spend time with these assignments; they are especially useful in showing the relevance and diversity of financial accounting and reporting.

*Special note:* The SEC maintains the EDGAR (**E**lectronic **D**ata **G**athering, **A**nalysis, and **R**etrieval) database at [www.sec.gov](http://www.sec.gov). The **Form 10-K** is the annual report form for most companies. It provides electronically accessible information. The **Form 10-KSB** is the annual report form filed by "small businesses." It requires slightly less information than the Form 10-K. One of these forms must be filed within 90 days after the company's fiscal year-end. (Forms 10-K405, 10-KT, 10-KT405, and 10-KSB405 are slight variations of the usual form due to certain regulations or rules.)



# Financial Report

## Selected Financial Data

The following table presents our selected financial data. Certain prior-year amounts have been reclassified to conform to the current-year presentation. All fiscal years presented reflect the classification of Musicland's financial results as discontinued operations.

### Five-Year Financial Highlights

*\$ in millions, except per share amounts*

Fiscal Year	2005	2004	2003	2002	2001
<b>Consolidated Statements of Earnings Data</b>					
Revenue	\$27,433	\$24,548	\$20,943	\$17,711	\$15,189
Operating income	1,442	1,304	1,010	908	611
Earnings from continuing operations	934	800	622	570	401
Loss from discontinued operations, net of tax	—	(29)	(441)	—	(5)
Gain (loss) on disposal of discontinued operations, net of tax	50	(66)	—	—	—
Cumulative effect of change in accounting principles, net of tax	—	—	(82)	—	—
Net earnings	984	705	99	570	396
<b>Per Share Data</b>					
Continuing operations	\$2.79	\$2.41	\$1.90	\$1.77	\$1.26
Discontinued operations	—	(0.09)	(1.34)	—	(0.02)
Gain (loss) on disposal of discontinued operations	0.15	(0.20)	—	—	—
Cumulative effect of accounting changes	—	—	(0.25)	—	—
Net earnings	2.94	2.13	0.31	1.77	1.24
Cash dividends declared and paid	0.42	0.40	—	—	—
Common stock price:					
High	62.20	62.70	53.75	51.47	59.25
Low	43.87	25.55	16.99	22.42	14.00
<b>Operating Statistics</b>					
Comparable store sales change	4.3%	7.1%	2.4%	1.9%	4.9%
Gross profit rate	23.7%	23.9%	23.6%	20.0%	18.5%
Selling, general and administrative expense rate	18.4%	18.6%	18.8%	14.9%	14.5%
Operating income rate	5.3%	5.3%	4.8%	5.1%	4.0%
<b>Year-End Data</b>					
Current ratio	1.4	1.3	1.3	1.2	1.1
Total assets	\$10,294	\$8,652	\$7,694	\$7,367	\$4,840
Long-term debt, including current portion	600	850	834	820	296
Total shareholders' equity	4,449	3,422	2,730	2,521	1,822
Number of stores					
U.S. Best Buy stores	668	608	548	481	419
Magnolia Audio Video stores	20	22	19	13	13
International stores	144	127	112	95	—
Total retail square footage (000s)					
U.S. Best Buy stores	28,260	26,421	24,243	21,599	19,010
Magnolia Audio Video stores	194	218	189	133	133
International stores	3,139	2,800	2,375	1,923	—

Fiscal 2001 included 53 weeks. All other periods presented included 52 weeks.

**Consolidated Balance Sheets**

\$ in millions, except per share amounts

Assets	February 26, 2005	February 28, 2004
<b>Current Assets</b>		
Cash and cash equivalents	\$ 470	\$ 245
Short-term investments	2,878	2,355
Receivables	375	343
Merchandise inventories	2,851	2,607
Other current assets	329	174
Total current assets	6,903	5,724
<b>Property and Equipment</b>		
Land and buildings	506	484
Leasehold improvements	1,139	861
Fixtures and equipment	2,458	2,151
Property under master and capital lease	89	78
	4,192	3,574
Less accumulated depreciation	1,728	1,330
Net property and equipment	2,464	2,244
<b>Goodwill</b>	513	477
<b>Tradename</b>	40	37
<b>Long-Term Investments</b>	148	—
<b>Other Assets</b>	226	170
<b>Total Assets</b>	<u>\$10,294</u>	<u>\$8,652</u>
<b>Liabilities and Shareholders' Equity</b>		
<b>Current Liabilities</b>		
Accounts payable	\$ 2,824	\$2,460
Unredeemed gift card liabilities	410	300
Accrued compensation and related expenses	234	269
Accrued liabilities	844	724
Accrued income taxes	575	380
Current portion of long-term debt	72	368
Total current liabilities	4,959	4,501
<b>Long-Term Liabilities</b>	358	247
<b>Long-Term Debt</b>	528	482
<b>Shareholders' Equity</b>		
Preferred stock, \$1.00 par value: Authorized — 400,000 shares; Issued and outstanding — none	—	—
Common stock, \$.10 par value: Authorized — 1 billion shares; Issued and outstanding — 328,342,000 and 324,648,000 shares, respectively	33	32
Additional paid-in capital	952	836
Retained earnings	3,315	2,468
Accumulated other comprehensive income	149	86
Total shareholders' equity	4,449	3,422
<b>Total Liabilities and Shareholders' Equity</b>	<u>\$10,294</u>	<u>\$8,652</u>

See Notes to Consolidated Financial Statements.

**Consolidated Statements of Earnings**  
\$ in millions, except per share amounts

For the Fiscal Years Ended	February 26, 2005	February 28, 2004	March 1, 2003
Revenue	\$27,433	\$24,548	\$20,943
Cost of goods sold	<u>20,938</u>	<u>18,677</u>	<u>15,998</u>
Gross profit	6,495	5,871	4,945
Selling, general and administrative expenses	<u>5,053</u>	<u>4,567</u>	<u>3,935</u>
Operating income	1,442	1,304	1,010
Net interest income (expense)	<u>1</u>	<u>(8)</u>	<u>4</u>
Earnings from continuing operations before income tax expense	1,443	1,296	1,014
Income tax expense	<u>509</u>	<u>496</u>	<u>392</u>
Earnings from continuing operations	934	800	622
Loss from discontinued operations (Note 2), net of \$17 and \$119 tax	—	(29)	(441)
Gain (loss) on disposal of discontinued operations (Note 2)	50	(66)	—
Cumulative effect of change in accounting principle for goodwill (Note 1), net of \$24 tax	—	—	(40)
Cumulative effect of change in accounting principle for vendor allowances (Note 1), net of \$26 tax	<u>—</u>	<u>—</u>	<u>(42)</u>
Net earnings	<u>\$ 984</u>	<u>\$ 705</u>	<u>\$ 99</u>
Basic earnings (loss) per share:			
Continuing operations	\$ 2.87	\$ 2.47	\$ 1.93
Discontinued operations	—	(0.09)	(1.37)
Gain (loss) on disposal of discontinued operations	0.15	(0.20)	—
Cumulative effect of accounting changes	<u>—</u>	<u>—</u>	<u>(0.25)</u>
Basic earnings per share	<u>\$ 3.02</u>	<u>\$ 2.18</u>	<u>\$ 0.31</u>
Diluted earnings (loss) per share: <sup>(1)</sup>			
Continuing operations	\$ 2.79	\$ 2.41	\$ 1.90
Discontinued operations	—	(0.09)	(1.34)
Gain (loss) on disposal of discontinued operations	0.15	(0.20)	—
Cumulative effect of accounting changes	<u>—</u>	<u>—</u>	<u>(0.25)</u>
Diluted earnings per share	<u>\$ 2.94</u>	<u>\$ 2.13</u>	<u>\$ 0.31</u>
Basic weighted average common shares outstanding (in millions)	325.9	323.3	321.1
Diluted weighted average common shares outstanding (in millions) <sup>(1)</sup>	336.6	333.9	330.7

<sup>(1)</sup> The calculation of diluted earnings per share assumes the conversion of our convertible debentures due in 2022 into 5.8 million shares of common stock and adds back related after-tax interest expense of \$6.5 for all periods presented.

See Notes to Consolidated Financial Statements.

### Consolidated Statements of Changes in Shareholders' Equity

\$ and shares in millions

	Common Shares	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
<b>Balances at March 2, 2002</b>	<b>319</b>	<b>\$31</b>	<b>\$ 702</b>	<b>\$1,794</b>	<b>\$ (6)</b>	<b>\$2,521</b>
Net earnings	—	—	—	99	—	99
Other comprehensive income (loss), net of tax:						
Foreign currency translation adjustments	—	—	—	—	34	34
Other	—	—	—	—	(1)	(1)
Total comprehensive income						132
Stock options exercised	3	1	43	—	—	44
Tax benefit from stock options exercised	—	—	33	—	—	33
<b>Balances at March 1, 2003</b>	<b>322</b>	<b>32</b>	<b>778</b>	<b>1,893</b>	<b>27</b>	<b>2,730</b>
Net earnings	—	—	—	705	—	705
Foreign currency translation adjustments	—	—	—	—	59	59
Total comprehensive income						764
Stock options exercised	5	—	114	—	—	114
Tax benefit from stock options exercised	—	—	41	—	—	41
Vesting of restricted stock awards	—	—	3	—	—	3
Common stock dividends, \$0.40 per share	—	—	—	(130)	—	(130)
Repurchase of common stock	(2)	—	(100)	—	—	(100)
<b>Balances at February 28, 2004</b>	<b>325</b>	<b>32</b>	<b>836</b>	<b>2,468</b>	<b>86</b>	<b>3,422</b>
Net earnings	—	—	—	984	—	984
Other comprehensive income, net of tax:						
Foreign currency translation adjustments	—	—	—	—	59	59
Other	—	—	—	—	4	4
Total comprehensive income						1,047
Stock options exercised	6	1	219	—	—	220
Tax benefit from stock options exercised and employee stock purchase plan	—	—	60	—	—	60
Issuance of common stock under employee stock purchase plan	1	—	36	—	—	36
Vesting of restricted stock awards	—	—	1	—	—	1
Common stock dividends, \$0.42 per share	—	—	—	(137)	—	(137)
Repurchase of common stock	(4)	—	(200)	—	—	(200)
<b>Balances at February 26, 2005</b>	<b>328</b>	<b>\$33</b>	<b>\$ 952</b>	<b>\$3,315</b>	<b>\$149</b>	<b>\$4,449</b>

See Notes to Consolidated Financial Statements.

**Consolidated Statements of Cash Flows**

\$ in millions

For the Fiscal Years Ended	February 26, 2005	February 28, 2004	March 1, 2003
<b>Operating Activities</b>			
Net earnings	\$ 984	\$ 705	\$ 99
(Gain) loss from and disposal of discontinued operations, net of tax	(50)	95	441
Cumulative effect of change in accounting principles, net of tax	—	—	82
Earnings from continuing operations	934	800	622
Adjustments to reconcile earnings from continuing operations to total cash provided by operating activities from continuing operations:			
Depreciation	459	385	310
Asset impairment charges	22	22	11
Deferred income taxes	(28)	(14)	(37)
Other	23	16	15
Changes in operating assets and liabilities, net of acquired assets and liabilities:			
Receivables	(30)	(27)	(89)
Merchandise inventories	(240)	(507)	(256)
Other assets	(190)	(25)	(21)
Accounts payable	347	272	(5)
Other liabilities	243	250	117
Accrued income taxes	301	197	111
Total cash provided by operating activities from continuing operations	<u>1,841</u>	<u>1,369</u>	<u>778</u>
<b>Investing Activities</b>			
Additions to property and equipment	(502)	(545)	(725)
Purchases of available-for-sale securities	(7,789)	(2,989)	(1,844)
Sales of available-for-sale securities	7,118	2,175	1,610
Other, net	7	1	49
Total cash used in investing activities from continuing operations	<u>(1,166)</u>	<u>(1,358)</u>	<u>(910)</u>
<b>Financing Activities</b>			
Long-term debt payments	(371)	(17)	(13)
Issuance of common stock under employee stock purchase plan and for the exercise of stock options	256	114	40
Repurchase of common stock	(200)	(100)	—
Dividends paid	(137)	(130)	—
Net proceeds from issuance of long-term debt	—	—	18
Other, net	(7)	46	(15)
Total cash (used in) provided by financing activities from continuing operations	<u>(459)</u>	<u>(87)</u>	<u>30</u>
Effect of Exchange Rate Changes on Cash	9	1	—
Net Cash Used in Discontinued Operations	—	(53)	(79)
Increase (Decrease) in Cash and Cash Equivalents	225	(128)	(181)
Cash and Cash Equivalents at Beginning of Year	245	373	554
Cash and Cash Equivalents at End of Year	<u>\$ 470</u>	<u>\$ 245</u>	<u>\$ 373</u>
<b>Supplemental Disclosure of Cash Flow Information</b>			
Income tax paid	\$ 241	\$ 306	\$ 283
Interest paid	35	22	24
Capital and financing lease obligations incurred	117	26	—

See Notes to Consolidated Financial Statements.

## Best Buy

### **SELECTED** Notes to Consolidated Financial Statements

*\$ in millions, except per share amounts*

#### **1. Summary of Significant Accounting Policies**

##### **Description of Business**

Best Buy Co., Inc. is a specialty retailer of consumer electronics, home-office products, entertainment software, appliances and related services.

We operate two reportable segments: Domestic and International. The Domestic segment is comprised of U.S. Best Buy and Magnolia Audio Video operations. At February 26, 2005, we operated 668 U.S. Best Buy stores in 48 states and the District of Columbia. At February 26, 2005, we operated 20 Magnolia Audio Video stores in California, Washington and Oregon. The International segment is comprised of Future Shop and Best Buy operations in Canada. At February 26, 2005, we operated 114 Future Shop stores throughout all Canadian provinces and 30 Canadian Best Buy stores in Ontario, Alberta, British Columbia, Manitoba and Saskatchewan. Future Shop and Canadian Best Buy stores offer products and services similar to those offered by U.S. Best Buy stores except that Canadian Best Buy stores do not sell appliances.

In support of our retail store operations, we also operate Geek Squad, a computer repair and service provider, and Web sites for each of our brands (BestBuy.com, BestBuyCanada.ca, FutureShop.ca, MagnoliaAV.com and GeekSquad.com).

##### **Fiscal Year**

Our fiscal year ends on the Saturday nearest the end of February. Fiscal 2005, 2004 and 2003 each included 52 weeks.

##### **Cash and Cash Equivalents**

Cash primarily consists of cash on hand and bank deposits. Cash equivalents primarily consist of money market accounts and other highly liquid investments with an original maturity of three months or less when

purchased. We carry these investments at cost, which approximates market value. The amount of cash equivalents at February 26, 2005, and February 28, 2004, was \$156 and \$73, respectively, and the weighted average interest rates were 2.9% and 0.9%, respectively.

Outstanding checks in excess of funds on deposit totaled \$393 and \$351 at February 26, 2005, and February 28, 2004, respectively, and are reflected as current liabilities.

##### **Merchandise Inventories**

Merchandise inventories are recorded at the lower of average cost or market. In-bound freight-related costs from our vendors are included as part of the net cost of merchandise inventories. Also included in the cost of inventory are certain vendor allowances that are not a reimbursement of specific, incremental and identifiable costs to promote a vendor's products. Other costs associated with acquiring, storing and transporting merchandise inventories to our retail stores are expensed as incurred and included in cost of goods sold.

Our inventory loss reserve represents anticipated physical inventory losses (e.g., theft) that have occurred since the last physical inventory date. Independent physical inventory counts are taken on a regular basis to ensure that the inventory reported in our consolidated financial statements is accurately stated. During the interim period between physical inventory counts, we reserve for anticipated physical inventory losses on a location-by-location basis.

##### **Property and Equipment**

Property and equipment are recorded at cost. We compute depreciation using the straight-line method over the estimated useful lives of the assets. Leasehold improvements are depreciated over the shorter of their estimated useful lives or the period from the date the assets are placed in service to the end of the initial lease

*\$ in millions, except per share amounts*

term. Accelerated depreciation methods are generally used for income tax purposes.

Repairs and maintenance costs are charged directly to expense as incurred. Major renewals or replacements that substantially extend the useful life of an asset are capitalized and depreciated.

Estimated useful lives by major asset category are as follows:

Asset	Life (in years)
Buildings	30-40
Leasehold improvements	10-25
Fixtures and equipment	3-15
Property under master and capital lease	3-35

### Goodwill and Intangible Assets

#### *Goodwill*

Goodwill is the excess of the purchase price over the fair value of identifiable net assets acquired in business combinations accounted for under the purchase method. Effective March 3, 2002, we adopted SFAS No. 142, *Goodwill and Other Intangible Assets*, which eliminated the systematic amortization of goodwill. This Statement also requires that we review goodwill for impairment at adoption and at least annually thereafter.

During the fourth quarter of fiscal 2005, we completed our annual impairment testing of our goodwill and tradename, using the same valuation techniques as described above, and determined there was no impairment.

#### *Tradenname*

We have an indefinite-lived intangible asset related to our Future Shop tradename that totaled \$40 and \$37 at February 26, 2005, and February 28, 2004, respectively, which is included in the International segment. The change in the indefinite-lived intangible asset balance from February 28, 2004, was the result of fluctuations in foreign currency exchange rates.

#### *Lease Rights*

Lease rights, representing costs incurred to acquire the lease of a specific commercial property, are recorded at

cost and are amortized to rent expense over the remaining lease term, which ranges up to 16 years, beginning with the date we take possession of the property.

The gross cost and accumulated amortization of lease rights were \$27 and \$29; and \$9 and \$6, respectively, at February 26, 2005, and February 28, 2004, respectively. Lease rights amortization was \$4, \$4 and \$2 for fiscal 2005, 2004 and 2003, respectively. Current lease rights amortization is expected to be approximately \$3 for each of the next five fiscal years.

### Income Taxes

We account for income taxes under the liability method. Under this method, deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted income tax rates in effect for the year in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in income tax rates is recognized in our statement of earnings in the period that includes the enactment date. A valuation allowance is recorded to reduce the carrying amounts of deferred tax assets if it is more likely than not that such assets will not be realized.

### Long-Term Liabilities

The major components of long-term liabilities at February 26, 2005, and February 28, 2004, included deferred compensation plan liabilities, long-term rent-related liabilities, deferred income taxes and advances received under vendor alliance programs.

### Foreign Currency

Foreign currency denominated assets and liabilities are translated into U.S. dollars using the exchange rates in effect at the balance sheet date. Results of operations and cash flows are translated using the average exchange rates throughout the period. The effect of exchange rate

*\$ in millions, except per share amounts*

fluctuations on translation of assets and liabilities is included as a component of shareholders' equity in accumulated other comprehensive income. Gains and losses from foreign currency transactions, which are included in SG&A, have not been significant.

### Revenue Recognition

We recognize revenue from the sale of merchandise at the time the customer takes possession of the merchandise. We recognize service revenue at the time the service is provided, the sales price is fixed or determinable, and collectibility is reasonably assured. Proceeds from the sale of gift cards are deferred until the customer uses the gift card to acquire merchandise or services. Amounts billed to customers for shipping and handling are included in revenue. An allowance has been established for estimated sales returns.

We sell extended service contracts on behalf of an unrelated third party. In jurisdictions where we are not deemed to be the obligor on the contract, commissions are recognized in revenue at the time of sale. In jurisdictions where we are deemed to be the obligor on

the contract, commissions are recognized in revenue ratably over the term of the service contract.

### Sales Incentives

We frequently offer sales incentives that entitle our customers to receive a reduction in the price of a product or service. Sales incentives include discounts, coupons and other offers that entitle a customer to receive a reduction in the price of a product or service by submitting a claim for a refund or rebate. For sales incentives in which we are the obligor, the reduction in revenue is recognized at the time the product is sold.

We have a customer loyalty program which allows members to earn points for each purchase completed at U.S. Best Buy stores. Points earned enable members to receive a certificate that may be redeemed on future purchases at U.S. Best Buy stores. The value of points earned by our loyalty program members is included in accrued liabilities and recorded as a reduction of revenue at the time the points are earned, based on the percentage of points that are projected to be redeemed.

### Costs of Goods Sold and Selling, General and Administrative Expenses

The following table illustrates the primary costs classified in each major expense category.

Cost of Goods Sold	SG&A
<ul style="list-style-type: none"> <li>• Total cost of products sold including:               <ul style="list-style-type: none"> <li>— Freight expenses associated with moving merchandise inventories from our vendors to our distribution centers;</li> <li>— Vendor allowances that are not a reimbursement of specific, incremental and identifiable costs to promote a vendor's products;</li> </ul> </li> <li>• Costs of services provided;</li> <li>• Physical inventory losses;</li> <li>• Markdowns;</li> <li>• Customer shipping and handling expenses;</li> <li>• Costs associated with operating our distribution network, including payroll and benefit costs, occupancy costs, and depreciation; and</li> <li>• Freight expenses associated with moving merchandise inventories from our distribution centers to our retail stores.</li> </ul>	<ul style="list-style-type: none"> <li>• Payroll and benefit costs for retail and corporate employees;</li> <li>• Occupancy costs of retail, services and corporate facilities;</li> <li>• Depreciation related to retail, services and corporate assets;</li> <li>• Advertising;</li> <li>• Vendor allowances that are a reimbursement of specific, incremental and identifiable costs to promote a vendor's products;</li> <li>• Outside service fees;</li> <li>• Long-lived asset impairment charges; and</li> <li>• Other administrative costs, such as credit card service fees, supplies, and travel and lodging.</li> </ul>

\$ in millions, except per share amounts

### Advertising Costs

Advertising costs, which are included in SG&A, are expensed the first time the advertisement runs. Advertising costs consist primarily of print and television advertisements as well as promotional events. Gross advertising expenses, before expense reimbursement from vendor allowances, for fiscal 2005, 2004 and 2003 were \$712, \$675 and \$567, respectively.

### Stock-Based Compensation

We have a stock-based compensation plan that includes stock options and restricted stock. We also have an employee stock purchase plan. The table below illustrates the effect on net earnings and earnings per share as if we had applied the fair value recognition provisions of SFAS No. 123 to stock-based compensation for each of the last three fiscal years.

	2005	2004	2003
Net earnings, as reported	\$ 984	\$ 705	\$ 99
Add: Stock-based compensation expense included in reported net earnings, net of tax <sup>(1)</sup>	(1)	5	1
Deduct: Stock-based compensation expense determined under fair value method for all awards, net of tax <sup>(2)</sup>	(60)	(101)	(85)
Net earnings, pro forma	<u>\$ 923</u>	<u>\$ 609</u>	<u>\$ 15</u>
Earnings per share:			
Basic — as reported	\$3.02	\$2.18	\$0.31
Basic — pro forma	\$2.83	\$1.88	\$0.05
Diluted — as reported	\$2.94	\$2.13	\$0.31
Diluted — pro forma	\$2.80	\$1.88	\$0.05

<sup>(1)</sup> Amounts represent the after-tax compensation costs for restricted stock awards.

<sup>(2)</sup> In the fourth quarter of fiscal 2005, we increased our expected participant stock option forfeiture rate as a result of transferring to a third-party provider certain corporate employees, and the departure of certain senior executives. This higher level of expected stock option forfeitures reduced our fiscal 2005 pro forma stock-based compensation expense. Fiscal 2005 pro forma stock-based compensation expense may not be indicative of future stock-based compensation expense.

## 2. Discontinued Operations

In fiscal 2004, we sold our interest in Musicland. The buyer assumed all of Musicland's liabilities, including approximately \$500 in lease obligations, in exchange for all of the capital stock of Musicland and paid no cash consideration. The transaction also resulted in the transfer of all of Musicland's assets, other than a distribution center in Franklin, Indiana, and selected nonoperating assets. The loss from discontinued operations for fiscal 2004 included a loss on the disposal of discontinued operations (which was primarily noncash) of \$66, net of tax, related to the sale of Musicland. In connection with the sale, Musicland purchased transition support services from us for approximately one year from the date of the sale.

In accordance with SFAS No. 144, Musicland's financial results are reported separately as discontinued operations for all periods presented.

During fiscal 2003, we recorded an after-tax, noncash impairment charge of \$308 for the full write-off of goodwill related to our acquisition of Musicland. In addition, we recorded an after-tax, noncash charge of \$8 for the change in our method of accounting for Musicland vendor allowances. The charges are classified as cumulative effects of changes in accounting principles in discontinued operations (see Note 1, *Summary of Significant Accounting Policies*).

Also during fiscal 2003, in accordance with SFAS No. 144, we recorded a pre-tax impairment charge of \$166 related to a reassessment of the carrying value of

\$ in millions, except per share amounts

Musicland's long-lived assets. The \$166 charge was recorded in loss before income taxes, in the table below. We determined fair values utilizing widely accepted valuation techniques, including discounted cash flows. We

based fair values on the then-current expectations for the business in light of the then-existing retail environment and the uncertainty associated with future trends in prerecorded music products.

The financial results of Musicland, included in discontinued operations, were as follows:

For the Fiscal Years Ended	Feb. 26, 2005	Feb. 28, 2004 <sup>(1)</sup>	March 1, 2003
Revenue	\$—	\$354	\$1,727
Loss before income taxes	—	(46)	(244)
Loss before the disposal and the cumulative effect of accounting changes, net of \$17 and \$119 tax, respectively	—	(29)	(125)
Gain (loss) on disposal of discontinued operations <sup>(2)</sup>	50	(66)	—
Cumulative effect of change in accounting principles, net of \$5 tax	—	—	(316)
Gain (loss) from discontinued operations, net of tax	\$50	\$ (95)	\$ (441)

<sup>(1)</sup> Fiscal 2004 includes operating results from March 2, 2003, through June 16, 2003, the date we sold our interest in Musicland.

<sup>(2)</sup> Fiscal 2005 gain on disposal of discontinued operations represents the reversal of valuation allowances on deferred tax assets as described below. Fiscal 2004 loss on disposal of discontinued operations is net of \$25 tax benefit offset by a \$25 valuation allowance.

### 3. Investments in Debt Securities

Our short-term and long-term investments are comprised of municipal and United States government debt securities. In accordance with SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, and based on our ability to market and sell these instruments, we classify auction-rate debt securities and other investments in debt securities as available-for-sale and carry them at amortized cost. Auction-rate debt securities are long-term bonds that are similar to short-term instruments because their interest rates are reset periodically and investments in these securities can be sold for cash on the auction date. We classify auction-rate debt securities as short-term or long-term investments based on the reset dates.

In accordance with our investment policy, we place our investments in debt securities with issuers who have high-quality credit and limit the amount of investment exposure to any one issuer. We seek to preserve principal and minimize exposure to interest-rate fluctuations by limiting default risk, market risk and reinvestment risk.

On an annual basis, we review the key characteristics of our debt securities portfolio and their classification in accordance with GAAP. If a decline in the fair value of a security is deemed by management to be other than temporary, the cost basis of the investment is written down to fair value, and the amount of the write-down is included in the determination of income.

During our annual review in the fourth quarter of fiscal 2005, we reclassified our auction-rate debt securities from cash and cash equivalents to short-term investments or long-term investments, as appropriate, for all periods presented. The amortized cost of the securities reclassified for fiscal 2004 was \$2,355. The unrealized gain on the securities in conjunction with this reclassification was not significant.

We also revised the presentation in the consolidated statements of cash flows for the years ended February 28, 2004, and March 1, 2003, to reflect the gross purchases and sales of these securities as investing activities rather than as a component of cash and cash equivalents, which is consistent with the presentation for the fiscal year ended February 26, 2005.

\$ in millions, except per share amounts

The carrying amount of our investments in debt securities approximated fair value of February 26, 2005, and February 28, 2004, respectively, due to the rapid turnover of our portfolio and the highly liquid nature of these investments. Therefore, there were no significant unrealized holding gains or losses.

The following table presents the amortized principal amounts, related weighted average interest rates, maturities and major security types for our investments in debt securities:

	February 26, 2005		February 28, 2004	
	Amortized Principal Amount	Weighted Average Interest Rate	Amortized Principal Amount	Weighted Average Interest Rate
Short-term investments (less than one year)	\$2,878	3.22%	\$2,355	1.59%
Long-term investments (one to three years)	148	3.73%	—	—
Total	<u>\$3,026</u>		<u>\$2,355</u>	
Municipal debt securities	\$3,019		\$2,355	
Debt securities issued by U.S. Treasury and other U.S. government entities	7		—	
Total	<u>\$3,026</u>		<u>\$2,355</u>	

#### 4. Debt

	Feb. 26, 2005	Feb. 28, 2004
Convertible subordinated debentures, unsecured, due 2022, initial interest rate 2.25%	\$402	\$ 402
Convertible debentures, unsecured, due 2021, interest rate 2.75% <sup>(1)</sup>	—	353
Master lease obligations, due 2006, interest rate 5.9%	55	58
Capital lease obligations, due 2005, interest rates ranging from 5.5% to 8.0%	13	16
Financing lease obligations, due 2008 to 2022, interest rates ranging from 5.6% to 6.0% <sup>(2)</sup>	107	—
Mortgage and other debt, interest rates ranging from 1.8% to 8.9%	23	21
Total debt	600	850
Less: current portion	(72)	(368)
Total long-term debt	<u>\$528</u>	<u>\$ 482</u>

<sup>(1)</sup> In June 2004, we redeemed our convertible debentures due in 2021, for \$355. No gain or loss was incurred.

<sup>(2)</sup> In fiscal 2005, we recorded \$107 of financing leases as a result of our review of our lease accounting practices. See Note 7, *Leases*, for further information.

The mortgage and other debt are secured by certain property and equipment with a net book value of \$98 and \$97 at February 26, 2005, and February 28, 2004, respectively.

#### Convertible Debentures

In January 2002, we sold convertible subordinated debentures having an aggregate principal amount of \$402. The proceeds from the offering, net of \$6 in offering expenses, were \$396. The debentures mature in

2022 and are callable at par, at our option, for cash on or after January 15, 2007.

Holders may require us to purchase all or a portion of their debentures on January 15, 2007; January 15, 2012; and January 15, 2017, at a purchase price equal

\$ in millions, except per share amounts

to 100% of the principal amount of the debentures plus accrued and unpaid interest up to but not including the date of purchase. We have the option to settle the purchase price in cash, stock, or a combination of cash and stock.

The debentures will be convertible into shares of our common stock at a conversion rate of 14.4927 shares per \$0.001 principal amount of debentures, equivalent to an initial conversion price of \$69.00 per share, if the closing price of our common stock exceeds a specified price for a specified period of time, if our credit rating falls below specified levels, if the debentures are called for redemption or if certain specified corporate transactions occur. At February 26, 2005, none of the criteria for conversion had been met. The debentures have an initial interest rate of 2.25% per annum. The interest rate may be reset, but not below 2.25% or above 3.25%, on July 15, 2006; July 15, 2011; and July 15, 2016. One of our subsidiaries has guaranteed the convertible debentures.

#### Credit Facilities

We have a \$200 bank revolving credit facility which is guaranteed by certain of our subsidiaries. The facility expires on December 22, 2009. Borrowings under this facility are unsecured and bear interest at rates specified in the credit agreement. We also pay certain facility and agent fees. The agreement contains covenants that require us to maintain certain financial ratios.

#### Other

The fair value of long-term debt approximated \$603 and \$902 as of February 26, 2005, and February 28, 2004, respectively, based on the ask prices quoted from external sources, compared with carrying values of \$600 and \$850, respectively.

The future maturities of long-term debt, including master and capitalized leases, consist of the following:

Fiscal Year	
2006	\$ 72
2007 <sup>(1)</sup>	415
2008	14
2009	14
2010	20
Thereafter	<u>65</u>
	<u>\$600</u>

<sup>(1)</sup> Holders of our debentures due in 2022 may require us to purchase all or a portion of their debentures on January 15, 2007. The table above assumes that all holders of our debentures exercise their redemption options.

#### 5. Shareholders' Equity Stock Compensation Plans

Outstanding options were granted at exercise prices equal to the fair market value of our common stock on the date of grant and have a 10-year term. Options issued to employees generally vest over a four-year period. Options issued to our directors vest immediately upon grant.

#### Earnings per Share

Basic earnings per share is computed based on the weighted average number of common shares outstanding. Diluted earnings per share is computed based on the weighted average number of common shares outstanding adjusted by the number of additional shares that would have been outstanding had the potentially dilutive common shares been issued. Potentially dilutive shares of common stock include stock options, unvested restricted stock awards, shares issuable under our ESPP as well as common shares that would have resulted from the assumed conversion of our convertible debentures (see Note 4, *Debt*). Since the potentially dilutive shares related to the convertible debentures are included in the calculation, the related interest, net of tax, is added back to income from continuing operations, as the interest would not have been paid if the convertible debentures were converted to common stock.

\$ in millions, except per share amounts

The following table presents a reconciliation of the numerators and denominators of basic and diluted earnings per share from continuing operations for fiscal 2005, 2004 and 2003:

	2005	2004	2003
Numerator:			
Earnings from continuing operations, basic	\$ 934	\$ 800	\$ 622
Adjustment for assumed dilution:			
Interest on convertible debentures due in 2022, net of tax	<u>7</u>	<u>6</u>	<u>6</u>
Earnings from continuing operations, diluted	<u>\$ 941</u>	<u>\$ 806</u>	<u>\$ 628</u>
Denominator (in millions):			
Weighted average common shares outstanding	325.9	323.3	321.1
Effect of dilutive securities:			
Shares from assumed conversion of convertible debentures	5.8	5.8	5.8
Stock options and other	<u>4.9</u>	<u>4.8</u>	<u>3.8</u>
Weighted average common shares outstanding, assuming dilution	<u>336.6</u>	<u>333.9</u>	<u>330.7</u>
Basic earnings per share — continuing operations	\$ 2.87	\$ 2.47	\$ 1.93
Diluted earnings per share — continuing operations	\$ 2.79	\$ 2.41	\$ 1.90

### Repurchase of Common Stock

In June 2004, our Board authorized the purchase of up to \$500 of our common stock from time to time through open market purchases. The \$500 share repurchase program, which became effective on June 24, 2004, terminated and replaced the \$400 share repurchase program authorized by our Board in fiscal 2000.

In April 2005, our Board authorized the purchase of up to \$1.5 billion of our common stock from time to time through open market purchases. This share repurchase program has no stated expiration date. The \$1.5 billion share repurchase program terminated and replaced the \$500 share repurchase program authorized by our Board in June 2004.

During fiscal 2005, we purchased and retired 2.3 million shares at a cost of \$118 under the \$500 share

repurchase program, and 1.6 million shares at a cost of \$82 under the \$400 share repurchase program.

### Comprehensive Income

Comprehensive income is computed as net earnings plus certain other items that are recorded directly to shareholders' equity. The only significant other item included in comprehensive income is foreign currency translation adjustments. Foreign currency translation adjustments do not include a provision for income tax because earnings from foreign operations are considered to be indefinitely reinvested outside the U.S. Investment gains/losses were not significant.

\$ in millions, except per share amounts

## 6. Net Interest Income (Expense)

Net interest income (expense) for fiscal 2005, 2004 and 2003 was comprised of the following

	2005	2004	2003
Interest expense <sup>(1)</sup>	\$(44)	\$(32)	\$(30)
Capitalized interest	—	1	5
Interest income	<u>45</u>	<u>23</u>	<u>23</u>
Net interest income (expense)	1	(8)	(2)
Interest expense allocated to discontinued operations <sup>(2)</sup>	<u>—</u>	<u>—</u>	<u>(6)</u>
Net interest income (expense) from continuing operations	<u>\$ 1</u>	<u>\$ (8)</u>	<u>\$ 4</u>

<sup>(1)</sup> Fiscal 2005 interest expense includes \$21 of expense related to our lease accounting corrections.

<sup>(2)</sup> We allocated interest expense to discontinued operations based upon debt that was attributable to Musicland's operation.

## 7. Leases

We lease portions of our corporate facilities and conduct the majority of our retail and distribution operations from leased locations. The leases require payment of real estate taxes, insurance and common area maintenance, in addition to rent. The terms of our lease agreements generally range up to 20 years. Most of the leases contain renewal options and escalation clauses, and certain store leases require contingent rents based on specified percentages of revenue. Other leases contain covenants related to the maintenance of financial ratios.

For leases that contain predetermined fixed escalations of the minimum rent, we recognize the related rent expense on a straight-line basis from the date we take possession of the property to the end of the initial lease term. We record any difference between the straight-line rent amounts and amounts payable under the leases as part of deferred rent, in accrued liabilities or long-term liabilities, as appropriate.

Cash or lease incentives (tenant allowances) received upon entering into certain store leases are recognized on a straight-line basis as a reduction to rent from the date we take possession of the property through the end of the initial lease term. We record the unamortized portion of tenant allowances as a part of deferred rent, in accrued liabilities or long-term liabilities, as appropriate.

At February 26, 2005, and February 28, 2004, deferred rent included in accrued liabilities was approximately \$11 and \$3, respectively, and deferred rent included in long-term liabilities was approximately \$171 and \$73, respectively.

We also lease certain equipment under noncancelable operating and capital leases. Assets acquired under capital leases are depreciated over the shorter of the useful life of the asset or the initial lease term.

Rental expense for all operating leases, during the past three fiscal years, including leases of property and equipment, was as follows:

	2005	2004	2003
Net rent expense for continuing operations	\$501	\$468	\$440

\$ in millions, except per share amounts

The future minimum lease payments under our capital, financing and operating leases by fiscal year (not including contingent rentals) as of February 26, 2005, are as follows:

Fiscal Year	Capital Leases	Financing Leases	Operating Leases
2006	\$ 6	\$ 16	\$ 541
2007	2	15	541
2008	2	15	524
2009	2	14	511
2010	2	14	486
Thereafter	1	79	3,247
Subtotal	15	153	\$5,850
Less: imputed interest	(2)	(46)	
Present value of lease obligations	\$13	\$107	

## 8. Benefit Plans

We sponsor retirement savings plans for employees meeting certain age and service requirements. The plans provide for company-matching contributions, which are subject to annual approval by our Board. The total matching contributions were \$14, \$13 and \$13 in fiscal 2005, 2004 and 2003, respectively.

## 9. Income Taxes

Income tax expense was comprised of the following for the past three fiscal years:

	2005	2004	2003
Current:			
Federal	\$502	\$456	\$375
State	36	49	51
Foreign	(1)	5	3
	<u>537</u>	<u>510</u>	<u>429</u>
Deferred:			
Federal	(4)	(9)	(22)
State	(20)	(1)	(3)
Foreign	(4)	(4)	(12)
	<u>(28)</u>	<u>(14)</u>	<u>(37)</u>
Income tax expense	<u>\$509</u>	<u>\$496</u>	<u>\$392</u>

Deferred taxes are the result of differences between the bases of assets and liabilities for financial reporting and income tax purposes.

## 10. Segments

We operate two reportable segments: Domestic and International. The Domestic segment is comprised of U.S. Best Buy and Magnolia Audio Video operations. The International segment is comprised of Future Shop and Best Buy operations in Canada. Our segments are evaluated on an operating income basis, and a stand-alone tax provision is not calculated for each segment.

The following table presents our business segment information for continuing operations.

	2005
<b>Revenue</b>	
Domestic	\$24,616
International	2,817
Total revenue	<u>\$27,433</u>
<b>Operating Income</b>	
Domestic	\$ 1,393
International	49
Total operating income	1,442
Net interest income (expense)	1
Earnings from continuing operations before income tax expense	<u>\$ 1,443</u>
<b>Assets</b>	
Domestic	\$ 8,372
International	1,922
Total assets	<u>\$10,294</u>

*\$ in millions, except per share amounts*

## 11. Contingencies and Commitments

### *Contingencies*

We are involved in various other legal proceedings arising in the normal course of conducting business. We believe the amounts provided in our consolidated financial statements, as prescribed by GAAP, are adequate in light of the probable and estimable liabilities. The resolution of those proceedings is not expected to have a material impact on our results of operation or financial condition.

### *Commitments*

In 2004, we engaged Accenture LLP to assist us with improving our operational capabilities and reducing our costs in the Human Resources and Information Systems areas. Our future contractual obligations to Accenture are expected to range from \$124 to \$235 per year through 2011, the end of the contract period. Prior to our engagement of Accenture, a significant portion of these costs were incurred as part of normal operations.

We had outstanding letters of credit for purchase obligations with a fair value of \$92 as of February 26, 2005.

As of February 26, 2005, we had commitments for the purchase and construction of facilities valued at approximately \$83. Also, as of February 26, 2005, we had entered into lease commitments for land and buildings for 73 future locations. These lease commitments with real estate developers provide for minimum rentals ranging from 10 to 20 years, which if consummated based on current cost estimates, will approximate \$53 annually over the lease terms.

We assumed a liability for certain extended service contracts when we acquired Future Shop in fiscal 2002. We established an accrued liability for the acquired extended service contracts based on historical trends in product failure rates and the expected material and labor costs necessary to provide the services. The remaining terms of these acquired extended service contracts vary by product and extend through fiscal 2007. The estimated remaining liability for acquired extended service contracts at February 26, 2005, was \$9. Subsequent to the acquisition, all new extended service contracts were sold on behalf of an unrelated third party, without recourse.



# Financial Report

CIRCUIT CITY

## CONSOLIDATED BALANCE SHEETS

<i>(Amounts in thousands except share data)</i>	At February 28 or 29	
	2005	2004
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents.....	\$ 879,660	\$ 783,471
Short-term investments .....	125,325	—
Accounts receivable, net of allowance for doubtful accounts of \$120 and \$547 .....	172,995	170,568
Retained interests in securitized receivables .....	—	425,678
Merchandise inventory.....	1,459,520	1,517,256
Deferred income taxes.....	29,518	—
Prepaid expenses and other current assets.....	18,697	22,088
<b>TOTAL CURRENT ASSETS .....</b>	<b>2,685,715</b>	<b>2,919,061</b>
Property and equipment, net.....	738,802	677,107
Deferred income taxes.....	73,558	88,146
Goodwill .....	215,884	—
Other intangible assets .....	31,331	—
Other assets .....	44,092	46,212
<b>TOTAL ASSETS.....</b>	<b>\$3,789,382</b>	<b>\$3,730,526</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable.....	\$ 961,718	\$ 833,825
Accrued expenses and other current liabilities.....	228,966	149,605
Accrued income taxes .....	72,274	71,163
Deferred income taxes.....	—	79,422
Current installments of long-term debt.....	888	1,115
Liabilities of discontinued operations .....	—	3,068
<b>TOTAL CURRENT LIABILITIES .....</b>	<b>1,263,846</b>	<b>1,138,198</b>
Long-term debt, excluding current installments.....	11,522	22,691
Accrued straight-line rent and deferred rent credits .....	230,426	206,784
Accrued lease termination costs.....	104,234	75,722
Other liabilities.....	91,920	63,170
<b>TOTAL LIABILITIES .....</b>	<b>1,701,948</b>	<b>1,506,565</b>
<b>STOCKHOLDERS' EQUITY:</b>		
Common stock, \$0.50 par value; 525,000,000 shares authorized; 188,150,383 shares issued and outstanding (203,899,395 in 2004) .....	94,075	101,950
Capital in excess of par value.....	721,038	922,600
Retained earnings.....	1,247,221	1,199,411
Accumulated other comprehensive income.....	25,100	—
<b>TOTAL STOCKHOLDERS' EQUITY .....</b>	<b>2,087,434</b>	<b>2,223,961</b>
Commitments and contingent liabilities [NOTES 12, 13 AND 16]		
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY.....</b>	<b>\$3,789,382</b>	<b>\$3,730,526</b>

See accompanying notes to consolidated financial statements.

### CONSOLIDATED STATEMENTS OF OPERATIONS

<i>(Amounts in thousands except per share data)</i>	Years Ended February 28 or 29					
	2005	%	2004	%	2003	%
<b>NET SALES AND OPERATING REVENUES</b> .....	<b>\$10,472,364</b>	<b>100.0</b>	\$9,857,057	100.0	\$10,054,864	100.0
Cost of sales, buying and warehousing .....	<u>7,903,641</u>	<u>75.5</u>	7,573,049	76.8	7,647,992	76.1
<b>GROSS PROFIT</b> .....	<b>2,568,723</b>	<b>24.5</b>	2,284,008	23.2	2,406,872	23.9
Finance income .....	5,564	0.1	32,693	0.3	27,292	0.3
Selling, general and administrative expenses .....	<u>2,457,032</u>	<u>23.5</u>	2,277,479	23.1	2,385,310	23.7
Stock-based compensation expense .....	19,400	0.2	38,658	0.4	53,251	0.5
Interest expense .....	<u>2,066</u>	<u>—</u>	1,804	—	1,093	—
Earnings (loss) from continuing operations before income taxes .....	95,789	0.9	(1,240)	—	(5,490)	(0.1)
Income tax provision (benefit) .....	<u>35,878</u>	<u>0.3</u>	(453)	—	(181)	—
<b>NET EARNINGS (LOSS) FROM CONTINUING OPERATIONS</b> .....	<b>59,911</b>	<b>0.6</b>	(787)	—	(5,309)	(0.1)
<b>NET EARNINGS (LOSS) FROM DISCONTINUED OPERATIONS</b> .....	<u>1,747</u>	<u>—</u>	(88,482)	(0.9)	87,572	0.9
<b>NET EARNINGS (LOSS)</b> .....	<b>\$ 61,658</b>	<b>0.6</b>	\$ (89,269)	(0.9)	\$ 82,263	0.8
Net earnings (loss) from discontinued operations attributed to:						
Circuit City common stock .....	<u>\$ 1,747</u>		<u>\$ (88,482)</u>		<u>\$ 65,264</u>	
CarMax Group common stock .....	<u>\$ —</u>		<u>\$ —</u>		<u>\$ 22,308</u>	
Weighted average common shares:						
Circuit City:						
Basic .....	<u>193,466</u>		<u>205,865</u>		<u>207,217</u>	
Diluted .....	<u>196,227</u>		<u>205,865</u>		<u>207,217</u>	
CarMax Group:						
Basic .....	<u>—</u>		<u>—</u>		<u>37,023</u>	
Diluted .....	<u>—</u>		<u>—</u>		<u>38,646</u>	
<b>NET EARNINGS (LOSS) PER SHARE:</b>						
Basic:						
Continuing operations .....	\$ 0.31		\$ —		\$ (0.03)	
Discontinued operations attributed to Circuit City common stock .....	<u>0.01</u>		<u>(0.43)</u>		<u>0.31</u>	
	<u>\$ 0.32</u>		<u>\$ (0.43)</u>		<u>\$ 0.29</u>	
Discontinued operations attributed to CarMax Group common stock .....	<u>—</u>		<u>—</u>		<u>0.60</u>	
Diluted:						
Continuing operations .....	\$ 0.31		\$ —		\$ (0.03)	
Discontinued operations attributed to Circuit City common stock .....	<u>0.01</u>		<u>(0.43)</u>		<u>0.31</u>	
	<u>\$ 0.31</u>		<u>\$ (0.43)</u>		<u>\$ 0.29</u>	
Discontinued operations attributed to CarMax Group common stock .....	<u>—</u>		<u>—</u>		<u>0.58</u>	

See accompanying notes to consolidated financial statements.

### CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME

<i>(Amounts in thousands except per share data)</i>	Shares Outstanding		Common Stock		Capital In Excess of Par Value	Retained Earnings	Accumulated Other Comprehensive Income	Total
	Circuit City	CarMax Group	Circuit City	CarMax Group				
<b>BALANCE AT FEBRUARY 28, 2002</b> .....	208,823	36,851	\$ 104,411	\$ 18,426	\$893,537	\$1,744,129	\$ —	\$2,760,503
Net earnings and comprehensive income .....	—	—	—	—	—	82,263	—	82,263
Compensation for stock options.....	—	—	—	—	34,637	—	—	34,637
Exercise of common stock options .....	311	246	156	123	5,035	—	—	5,314
Shares issued under employee stock purchase plans .....	457	—	229	—	7,400	—	—	7,629
Shares issued under stock incentive plans .....	843	—	421	—	17,207	—	—	17,628
Tax effect from stock issued .....	—	—	—	—	5,986	—	—	5,986
Cancellation of restricted stock.....	(479)	(8)	(240)	(4)	(8,081)	—	—	(8,325)
Unearned compensation restricted stock .....	—	—	—	—	9,830	—	—	9,830
Cash dividends — common stock (\$0.07 per share).....	—	—	—	—	—	(14,687)	—	(14,687)
Distribution of CarMax, Inc. common stock to stockholders.....	—	(37,089)	—	(18,545)	—	(536,765)	—	(555,310)
Special dividend from CarMax .....	—	—	—	—	—	28,400	—	28,400
<b>BALANCE AT FEBRUARY 28, 2003</b> .....	209,955	—	104,977	—	965,551	1,303,340	—	2,373,868
Net loss and comprehensive loss .....	—	—	—	—	—	(89,269)	—	(89,269)
Repurchases of common stock.....	(9,266)	—	(4,633)	—	(79,720)	—	—	(84,353)
Compensation for stock options.....	—	—	—	—	24,184	—	—	24,184
Exercise of common stock options .....	1,369	—	685	—	11,843	—	—	12,528
Shares issued under stock incentive plans .....	2,546	—	1,273	—	19,312	—	—	20,585
Tax effect from stock issued .....	—	—	—	—	(10,595)	—	—	(10,595)
Cancellation of restricted stock.....	(705)	—	(352)	—	(10,074)	—	—	(10,426)
Unearned compensation restricted stock .....	—	—	—	—	2,099	—	—	2,099
Cash dividends — common stock (\$0.07 per share).....	—	—	—	—	—	(14,660)	—	(14,660)
<b>BALANCE AT FEBRUARY 29, 2004</b> .....	203,899	—	101,950	—	922,600	1,199,411	—	2,223,961
Comprehensive income:								
Net earnings .....	—	—	—	—	—	61,658	—	61,658
Other comprehensive income, net of taxes:								
Foreign currency translation adjustment (net of deferred taxes of \$13,707).....	—	—	—	—	—	—	25,100	25,100
Comprehensive income.....								86,758
Repurchases of common stock.....	(19,163)	—	(9,582)	—	(250,250)	—	—	(259,832)
Compensation for stock options.....	—	—	—	—	18,739	—	—	18,739
Exercise of common stock options .....	3,489	—	1,745	—	26,761	—	—	28,506
Shares issued under stock incentive plans .....	723	—	361	—	7,393	—	—	7,754
Tax effect from stock issued .....	—	—	—	—	(1,564)	—	—	(1,564)
Cancellation of restricted stock.....	(798)	—	(399)	—	(6,378)	—	—	(6,777)
Shares issued in acquisition of InterTAN, Inc. ....	—	—	—	—	6,498	—	—	6,498
Unearned compensation restricted stock .....	—	—	—	—	(2,761)	—	—	(2,761)
Cash dividends — common stock (\$0.07 per share).....	—	—	—	—	—	(13,848)	—	(13,848)
<b>BALANCE AT FEBRUARY 28, 2005</b> .....	<b>188,150</b>	<b>—</b>	<b>\$ 94,075</b>	<b>\$ —</b>	<b>\$721,038</b>	<b>\$1,247,221</b>	<b>\$25,100</b>	<b>\$2,087,434</b>

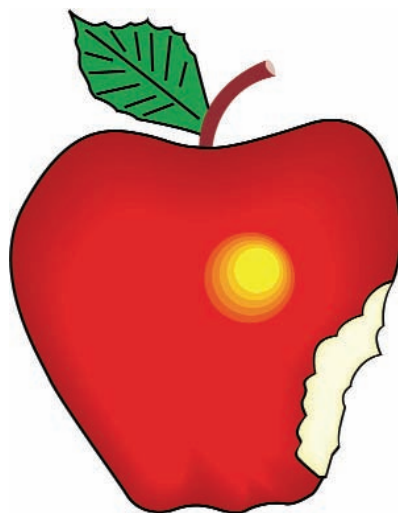
See accompanying notes to consolidated financial statements.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(Amounts in thousands)	Years Ended February 28 or 29		
	2005	2004	2003
<b>OPERATING ACTIVITIES:</b>			
Net earnings (loss).....	\$ 61,658	\$ (89,269)	\$ 82,263
Adjustments to reconcile net earnings (loss) to net cash provided by (used in) operating activities of continuing operations:			
Net (earnings) loss from discontinued operations .....	(1,747)	88,482	(87,572)
Depreciation and amortization .....	154,788	197,607	159,800
Stock option expense.....	18,739	24,184	30,823
Amortization of restricted stock awards.....	(434)	13,395	20,828
(Gain) loss on dispositions of property and equipment .....	(206)	7,500	15,659
Provision for deferred income taxes.....	(116,455)	(35,618)	(18,664)
Changes in operating assets and liabilities:			
(Increase) decrease in accounts receivable, net .....	(65,112)	(30,183)	6,229
Decrease (increase) in retained interests in securitized receivables .....	32,867	(186,537)	(92,888)
Decrease (increase) in merchandise inventory .....	159,278	(107,520)	(175,493)
Decrease (increase) in prepaid expenses and other current assets .....	7,148	(3,923)	21,081
Decrease (increase) in other assets .....	3,925	12,553	(26,181)
Increase (decrease) in accounts payable.....	101,991	(85,727)	(58,041)
Increase (decrease) in accrued expenses and other current liabilities, and accrued income taxes .....	36,008	50,577	(48,069)
Increase in other long-term liabilities .....	63,549	18,966	7,116
<b>NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES OF CONTINUING OPERATIONS.....</b>	<b>455,879</b>	<b>(125,513)</b>	<b>(163,109)</b>
<b>INVESTING ACTIVITIES:</b>			
Proceeds from the sale of the private-label operation .....	475,857	—	—
Acquisitions, net of cash acquired of \$30,615.....	(268,774)	—	—
Purchases of property and equipment.....	(269,166)	(175,769)	(150,757)
Proceeds from sales of property and equipment.....	106,369	40,427	59,888
Purchases of investment securities .....	(125,325)	—	—
<b>NET CASH USED IN INVESTING ACTIVITIES OF CONTINUING OPERATIONS.....</b>	<b>(81,039)</b>	<b>(135,342)</b>	<b>(90,869)</b>
<b>FINANCING ACTIVITIES:</b>			
Payments on short-term debt.....	(1,853)	—	(397)
Principal payments on long-term debt.....	(28,008)	(1,458)	(24,865)
Repurchases of common stock .....	(259,832)	(84,353)	—
Issuances of Circuit City common stock, net .....	27,156	11,391	8,901
Issuances of CarMax Group common stock, net .....	—	—	298
Dividends paid .....	(13,848)	(14,660)	(14,687)
<b>NET CASH USED IN FINANCING ACTIVITIES OF CONTINUING OPERATIONS.....</b>	<b>(276,385)</b>	<b>(89,080)</b>	<b>(30,750)</b>
<b>CASH (USED IN) PROVIDED BY DISCONTINUED OPERATIONS:</b>			
<b>BANKCARD OPERATION .....</b>	<b>(4,282)</b>	<b>248,736</b>	<b>(94,533)</b>
<b>CARMAX OPERATION .....</b>	<b>—</b>	<b>—</b>	<b>26,185</b>
<b>DIVX OPERATION .....</b>	<b>—</b>	<b>—</b>	<b>(10,500)</b>
<b>EFFECT OF EXCHANGE RATE CHANGES ON CASH.....</b>	<b>2,016</b>	<b>—</b>	<b>—</b>
Increase (decrease) in cash and cash equivalents .....	96,189	(101,199)	(363,576)
Cash and cash equivalents at beginning of year.....	783,471	884,670	1,248,246
<b>CASH AND CASH EQUIVALENTS AT END OF YEAR.....</b>	<b>\$ 879,660</b>	<b>\$ 783,471</b>	<b>\$ 884,670</b>

See accompanying notes to consolidated financial statements.

# Apple Financial Report



**CONSOLIDATED BALANCE SHEETS****(In millions, except share amounts)**

	<u>September 25, 2004</u>	<u>September 27, 2003</u>
<b>ASSETS:</b>		
Current assets:		
Cash and cash equivalents . . . . .	\$2,969	\$3,396
Short-term investments . . . . .	2,495	1,170
Accounts receivable, less allowances of \$47 and \$49, respectively . . . . .	774	766
Inventories . . . . .	101	56
Deferred tax assets . . . . .	231	190
Other current assets . . . . .	485	309
Total current assets . . . . .	<u>7,055</u>	<u>5,887</u>
Property, plant, and equipment, net . . . . .	707	669
Goodwill . . . . .	80	85
Acquired intangible assets . . . . .	17	24
Other assets . . . . .	191	150
Total assets . . . . .	<u>\$8,050</u>	<u>\$6,815</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY:</b>		
Current liabilities:		
Accounts payable . . . . .	\$1,451	\$1,154
Accrued expenses . . . . .	1,229	899
Current debt . . . . .	—	304
Total current liabilities . . . . .	<u>2,680</u>	<u>2,357</u>
Deferred tax liabilities and other non-current liabilities . . . . .	294	235
Total liabilities . . . . .	<u>2,974</u>	<u>2,592</u>
Shareholders' equity:		
Common stock, no par value; 900,000,000 shares authorized; 391,443,617 and 366,726,584 shares issued and outstanding, respectively . . . . .	2,514	1,926
Deferred stock compensation . . . . .	(93)	(62)
Retained earnings . . . . .	2,670	2,394
Accumulated other comprehensive income (loss) . . . . .	(15)	(35)
Total shareholders' equity . . . . .	<u>5,076</u>	<u>4,223</u>
Total liabilities and shareholders' equity . . . . .	<u>\$8,050</u>	<u>\$6,815</u>

See accompanying notes to consolidated financial statements.

### CONSOLIDATED STATEMENTS OF OPERATIONS

(In millions, except share and per share amounts)

Three fiscal years ended September 25, 2004	2004	2003	2002
Net sales . . . . .	\$ 8,279	\$ 6,207	\$ 5,742
Cost of sales . . . . .	6,020	4,499	4,139
Gross margin . . . . .	2,259	1,708	1,603
Operating expenses:			
Research and development . . . . .	489	471	446
Selling, general, and administrative . . . . .	1,421	1,212	1,109
Restructuring costs . . . . .	23	26	30
Purchased in-process research and development . . . . .	—	—	1
Total operating expenses . . . . .	1,933	1,709	1,586
Operating income (loss) . . . . .	326	(1)	17
Other income and expense:			
Gains (losses) on non-current investments, net . . . . .	4	10	(42)
Interest and other income, net . . . . .	53	83	112
Total other income and expense . . . . .	57	93	70
Income before provision for income taxes . . . . .	383	92	87
Provision for income taxes . . . . .	107	24	22
Income before accounting changes . . . . .	276	68	65
Cumulative effects of accounting changes, net of income taxes . . . . .	—	1	—
Net income . . . . .	\$ 276	\$ 69	\$ 65
Earnings per common share before accounting changes:			
Basic . . . . .	\$ 0.74	\$ 0.19	\$ 0.18
Diluted . . . . .	\$ 0.71	\$ 0.19	\$ 0.18
Earnings per common share:			
Basic . . . . .	\$ 0.74	\$ 0.19	\$ 0.18
Diluted . . . . .	\$ 0.71	\$ 0.19	\$ 0.18
Shares used in computing earnings per share (in thousands):			
Basic . . . . .	371,590	360,631	355,022
Diluted . . . . .	387,311	363,466	361,785

See accompanying notes to consolidated financial statements.

**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**

(In millions, except share amounts which are in thousands)

	Common Stock		Deferred Stock Compensation	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
	Shares	Amount				
Balances as of September 29, 2001 . . . . .	350,922	\$1,693	\$(11)	\$2,260	\$(22)	\$3,920
Components of comprehensive income:						
Net income . . . . .	—	—	—	65	—	65
Change in foreign currency translation . .	—	—	—	—	5	5
Change in unrealized gain on available- for-sale securities, net of tax . . . . .	—	—	—	—	(17)	(17)
Change in unrealized gain on derivative investments, net of tax . . . . .	—	—	—	—	(15)	(15)
Total comprehensive income . . . . .						38
Amortization of deferred stock compensation . . . . .	—	—	4	—	—	4
Common stock issued under stock plans . .	8,037	105	—	—	—	105
Tax benefit related to stock options . . . . .	—	28	—	—	—	28
Balances as of September 28, 2002 . . . . .	358,959	\$1,826	\$(7)	\$2,325	\$(49)	\$4,095
Components of comprehensive income:						
Net income . . . . .	—	—	—	69	—	69
Change in foreign currency translation . .	—	—	—	—	31	31
Change in unrealized gain on available- for-sale securities, net of tax . . . . .	—	—	—	—	(12)	(12)
Change in unrealized gain on derivative investments, net of tax . . . . .	—	—	—	—	(5)	(5)
Total comprehensive income . . . . .						83
Amortization of deferred stock compensation . . . . .	—	—	15	—	—	15
Write-off of deferred stock compensation . .	—	—	5	—	—	5
Common stock issued under stock plans . .	9,299	128	(75)	—	—	53
Settlement of forward purchase agreement . .	(1,531)	(35)	—	—	—	(35)
Tax benefit related to stock options . . . . .	—	7	—	—	—	7
Balances as of September 27, 2003 . . . . .	366,727	\$1,926	\$(62)	\$2,394	\$(35)	\$4,223
Components of comprehensive income:						
Net income . . . . .	—	—	—	276	—	276
Change in foreign currency translation . .	—	—	—	—	13	13
Change in unrealized gain on available- for-sale securities, net of tax . . . . .	—	—	—	—	(5)	(5)
Change in unrealized loss on derivative investments, net of tax . . . . .	—	—	—	—	12	12
Total comprehensive income . . . . .						296
Issuance of restricted stock units . . . . .	—	64	(64)	—	—	—
Adjustment to common stock related to a prior year acquisition . . . . .	(79)	(2)	—	—	—	(2)
Amortization of deferred stock compensation . . . . .	—	—	33	—	—	33
Common stock issued under stock plans . .	24,796	427	—	—	—	427
Tax benefit related to stock options . . . . .	—	99	—	—	—	99
Balances as of September 25, 2004 . . . . .	391,444	\$2,514	\$(93)	\$2,670	\$(15)	\$5,076

See accompanying notes to consolidated financial statements.

### CONSOLIDATED STATEMENTS OF CASH FLOWS

(In millions)

<u>Three fiscal years ended September 25, 2004</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>
Cash and cash equivalents, beginning of the year . . . . .	\$ 3,396	\$ 2,252	\$ 2,310
Operating Activities:			
Net income . . . . .	276	69	65
Cumulative effects of accounting changes, net of taxes . . . . .	—	(1)	—
Adjustments to reconcile net income to cash generated by operating activities:			
Depreciation, amortization and accretion . . . . .	150	113	114
Stock-based compensation expense . . . . .	33	16	5
Non-cash restructuring . . . . .	5	12	8
Provision for (benefit from) deferred income taxes . . . . .	20	(11)	(34)
Loss on disposition of property, plant, and equipment . . . . .	7	2	7
Gains on sales of short-term investments, net . . . . .	(1)	(21)	(7)
(Gains) losses on non-current investments, net . . . . .	(4)	(10)	42
Gain on forward purchase agreement . . . . .	—	(6)	—
Purchased in-process research and development . . . . .	—	—	1
Changes in operating assets and liabilities:			
Accounts receivable . . . . .	(8)	(201)	(99)
Inventories . . . . .	(45)	(11)	(34)
Other current assets . . . . .	(176)	(34)	(114)
Other assets . . . . .	(39)	(30)	(11)
Accounts payable . . . . .	297	243	110
Other liabilities . . . . .	419	159	36
Cash generated by operating activities . . . . .	<u>934</u>	<u>289</u>	<u>89</u>
Investing Activities:			
Purchases of short-term investments . . . . .	(3,270)	(2,648)	(4,144)
Proceeds from maturities of short-term investments . . . . .	1,141	2,446	2,846
Proceeds from sales of short-term investments . . . . .	801	1,116	1,254
Proceeds from sales of non-current investments . . . . .	5	45	25
Purchases of property, plant, and equipment . . . . .	(176)	(164)	(174)
Cash used for business acquisitions . . . . .	—	—	(52)
Other . . . . .	11	33	(7)
Cash generated by (used for) investing activities . . . . .	<u>(1,488)</u>	<u>828</u>	<u>(252)</u>
Financing Activities:			
Payment of long-term debt . . . . .	(300)	—	—
Proceeds from issuance of common stock . . . . .	427	53	105
Cash used for repurchase of common stock . . . . .	—	(26)	—
Cash generated by financing activities . . . . .	<u>127</u>	<u>27</u>	<u>105</u>
Increase (decrease) in cash and cash equivalents . . . . .	(427)	1,144	(58)
Cash and cash equivalents, end of the year . . . . .	<u>\$ 2,969</u>	<u>\$ 3,396</u>	<u>\$ 2,252</u>
Supplemental cash flow disclosures:			
Cash paid during the year for interest . . . . .	\$ 10	\$ 20	\$ 20
Cash paid (received) for income taxes, net . . . . .	\$ (7)	\$ 45	\$ 11

See accompanying notes to consolidated financial statements.