# **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 North America's No. 1 specialty retailer of name-brand consumer electronics, home office equipment, entertainment software and appliances. We operate three segments: Best Buy, Musicland and International. Best Buy is a specialty retailer of consumer electronics, home office equipment, entertainment software and appliances comprised of 481 stores in 44 states. Also included in the Best Buy segment is Seattle-based Magnolia Hi-Fi, a high-end retailer of audio and video products with 13 stores. Musicland, with more than 1,320 locations in the United States, Puerto Rico and the U.S. Virgin Islands, is primarily a mall-based retailer of prerecorded music, movies and other entertainment-related products. International is comprised of Future Shop, which currently operates 95 stores and is Canada's largest consumer electronics retailer, offering products similar to Best Buy.

### Basis of Presentation

The consolidated financial statements include the accounts of Best Buy Co., Inc. and its subsidiaries. Significant intercompany accounts and transactions have been eliminated. All subsidiaries are wholly owned.

### Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with generally accepted accounting principles requires us to make estimates and assumptions. These estimates and assumptions affect the reported amounts in the consolidated balance sheets and statements of earnings, as well as the disclosure of contingent liabilities. Actual results could differ from these estimates and assumptions.

### Fiscal Year

Our fiscal year ends on the Saturday nearest the end of February. Fiscal 2002 and 2000 each included 52 weeks, while fiscal 2001 included 53 weeks.

### Cash and Cash Equivalents

We consider highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. These investments are carried at cost, which approximates market value.

### Recoverable Costs From Developed Properties

The costs of acquisition and development of properties that we intend to sell and lease back or recover from landlords within one year are included in current assets.

### Merchandise Inventories

Merchandise inventories are recorded at the lower of cost or market. The primary methods used to determine cost are the average cost and retail inventory methods.

### Property and Equipment

Property and equipment are recorded at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets or, in the case of leasehold improvements, over the shorter of the estimated useful lives or lease terms. When indicators of impairment exist, we evaluate long-lived assets for impairment using an undiscounted cash flow analysis.

Estimated useful lives by major asset category are as follows:

| Asset | Life (in years) |
|---|---|
| Buildings | 30–40 |
| Leasehold improvements | 10–20 |
| Fixtures and equipment | 3–15 |
| Property under capital lease | 5–20 |

## 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. We periodically review goodwill for impairment and assess whether significant events or changes in business circumstances indicate that the carrying value of the goodwill may not be recoverable. An impairment loss would be recorded in the period such determination is made. Accumulated amortization was $22 and $2 in fiscal 2002 and 2001, respectively. See note 2 for additional discussion regarding goodwill.

## Revenue Recognition

We recognize revenues from the sale of merchandise at the time the merchandise is sold. We recognize service revenues at the time the service is provided, the sales price is fixed or determinable and collectibility is reasonably assured.

We sell extended service contracts, called Performance Service Plans, on behalf of an unrelated third party. In jurisdictions where we are not deemed to be the obligor on the contract at the time of sale, commissions are recognized in revenues at the time of sale. In jurisdictions where we are deemed to be the obligor on the contract at the time of sale, commissions are recognized in revenues ratably over the term of the service contract.

## Sales Incentives

We periodically offer sales incentives that entitle our customers to receive a reduction in the price of a product or service. For sales incentives in which we are the obligor, the reduction in revenues is recognized at the time the product or service is sold.

## Shipping and Handling Costs

Amounts billed to customers for shipping and handling are included in revenues. The related costs are included in cost of goods sold.

## 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 fluctuations on translation of assets and liabilities is recorded as a component of shareholders' equity. Gains and losses from foreign currency transactions are included in selling, general and administrative expenses.

## Comprehensive Income

Comprehensive income is net earnings, plus certain other items that are recorded directly to shareholders' equity. The only significant item currently applicable to us is foreign currency translation adjustments, which were not significant.

## Stock-Based Compensation

We account for employee stock-based compensation using the intrinsic value method as prescribed under Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations. We also present pro forma net earnings and earnings per share in note 4 as if we had adopted Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-Based Compensation*.

## Pre-Opening Costs

Non-capital expenditures associated with opening new stores are expensed as incurred.

## Advertising Costs

Advertising costs, which are included in selling, general and administrative expenses, are expensed the first time the advertisement runs. Gross advertising expenses, prior to reimbursement through cooperative advertising agreements, for fiscal 2002, 2001 and 2000 were $540, $479 and $374, respectively.

$ in millions, except per share amounts

### Derivative Financial Instruments

SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, requires that all derivatives be recorded on the balance sheet at fair value. At March 2, 2002, the fair value of existing interest-rate swaps was not significant.

### Reclassifications

Certain previous year amounts have been reclassified to conform to the current year presentation. These reclassifications had no impact on net earnings or financial position.

### New Accounting Standards

In June 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 141, *Business Combinations*, and No. 142, *Goodwill and Other Intangible Assets*, effective for fiscal years beginning after Dec. 15, 2001. Under these new standards, all acquisitions subsequent to June 30, 2001, must be accounted for by the purchase method of accounting, and goodwill is no longer amortized over its useful life. Rather, goodwill will be subject to an annual impairment test based on its fair value. Separable intangible assets that are determined to have a finite life will continue to be amortized over their useful lives. We are currently evaluating these pronouncements to determine the impact, if any, they may have on our net earnings or financial position.

In August 2001, the FASB issued SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, effective for fiscal years beginning after Dec. 15, 2001. This statement develops one accounting model (based on the model in SFAS No. 121) for long-lived assets to be disposed of, expands the scope of discontinued operations and modifies the accounting for discontinued operations. The adoption of this new statement is not expected to have material impact on our net earnings or financial position.

## 2. Acquisitions

Effective Nov. 4, 2001, we acquired all of the common stock of Future Shop for $377, or $368 net of cash acquired, including transaction costs. We acquired Future Shop to further our expansion plans and increase shareholder value. The acquisition was accounted for using the purchase method in accordance with SFAS No. 141. Accordingly, the net assets were recorded at their estimated fair values, and operating results were included in our financial statements from the date of acquisition. The purchase price was allocated on a preliminary basis using information currently available. The allocation of the purchase price to the assets and liabilities acquired will be finalized in fiscal 2003. We will adjust the allocation of the purchase price after obtaining more information regarding asset valuations, liabilities assumed and revisions of preliminary estimates of fair values made at the date of purchase. The preliminary allocations resulted in goodwill of approximately $406, which is non-deductible for tax purposes. Under SFAS No. 142, goodwill is not amortized.

The preliminary purchase price allocation was as follows:

| | |
|---|---|
| Merchandise inventories | $169 |
| Property and equipment | 108 |
| Other assets | 40 |
| Goodwill | 406 |
| Current liabilities | (342) |
| Long-term debt, including current portion | (13) |
| | $368 |

During the fourth quarter of fiscal 2001, we acquired the common stock of Magnolia Hi-Fi for $88 in cash, including transaction costs, and the common stock of Musicland for $425, including transaction costs, plus long-term debt valued at $271. The acquisitions were accounted for using the purchase method in accordance with APB Opinion No. 16, *Business Combinations*, and No. 17, *Intangible Assets*. The allocation of the purchase prices to the assets and liabilities acquired was finalized in the fourth quarter of fiscal 2002 and resulted in goodwill of $395, of which $326 is non-deductible for tax purposes. The goodwill was being amortized on a straight-line basis over 20 years and is included in selling, general and administrative expenses. Goodwill amortization associated with the acquisitions of Magnolia Hi-Fi and Musicland will cease at the beginning of fiscal 2003 with the adoption of SFAS No. 142. Application of the nonamortization provision of the new standard is expected to result in an increase in our net earnings of approximately $18 per year.

$ in millions, except per share amounts

The following unaudited pro forma data sets forth the consolidated results of operations as though Musicland and Future Shop had been acquired as of the beginning of fiscal 2001:

| | **2002** | **2001** |
|---|---|---|
| Revenues | $20,392 | $18,392 |
| Net earnings | 570 | 428 |
| Basic earnings per share | 1.80 | 1.38 |
| Diluted earnings per share | 1.77 | 1.34 |

Pro forma information related to the acquisition of Magnolia Hi-Fi is not presented, as the operating results of Magnolia Hi-Fi would not have had a material impact on our results of operations.

The pro forma results include goodwill amortization of $16, for Musicland only, and other adjustments, principally the loss of interest income on cash used to finance the acquisitions. The pro forma results for fiscal 2001 exclude costs expected to be incurred in connection with the integration and transformation of acquired businesses. The pro forma results are not necessarily indicative of what actually would have occurred had the acquisitions been completed as of the beginning of fiscal 2001, nor are they necessarily indicative of future consolidated results.

*$ in millions, except per share amounts*

## 3. Debt

| | March 2, 2002 | March 3, 2001 |
|---|---|---|
| Convertible debentures, unsecured, due 2021, initial interest rate 2.75% | $341 | $ — |
| Convertible subordinated debentures, unsecured, due 2022, initial interest rate 2.25% | 402 | — |
| Subordinated notes, face amount $110, unsecured, due 2003, interest rate 9.0%, effective rate 8.9% | — | 110 |
| Senior subordinated notes, face amount $150, unsecured, due 2008, interest rate 9.9%, effective rate 8.5% | 5 | 161 |
| Capital lease obligations, due 2006, interest rate 5.9% | 39 | — |
| Mortgage and other debt, interest rates ranging from 4.0% to 9.2% | 33 | 25 |
| Total debt | 820 | 296 |
| Less: current portion | (7) | (115) |
| Long-term debt | $813 | $181 |

The mortgage and other debt are secured by certain property and equipment with a net book value of $43 and $44 at March 2, 2002, and March 3, 2001, respectively.

### Convertible Debentures

In January 2002, we sold, in a private offering, 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 20 years and are callable at our option on or after Jan. 15, 2007. Holders may require us to purchase all or a portion of their debentures on Jan. 15, 2007; Jan. 15, 2012; and Jan. 15, 2017, at a purchase price equal to 100% of the principal amount of the debentures plus accrued and unpaid interest up to but not including the date of purchase. 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, or otherwise upon the occurrence of certain events. The debentures have an initial interest rate of 2.25%. The interest rate may be reset, but will not fall below 2.25% or above 3.25%, on July 15, 2006; July 15, 2011; and July 15, 2016. The debentures are guaranteed on an unsecured and subordinated basis by Best Buy Stores, L.P., our wholly owned indirect subsidiary. On Feb. 28, 2002, we filed a Registration Statement on Form S-3 with the Securities and Exchange Commission to register the debentures, the guarantee and the underlying shares of common stock. As of May 1, 2002, the Registration Statement had not yet been declared effective.

In June 2001, we sold, in a private offering, convertible debentures having an initial aggregate principal amount at maturity of $492. The proceeds from the offering, net of $7 in offering expenses, were $330. The debentures mature in 20 years and are callable at our option on or after June 27, 2004. Holders may require us to purchase all or a portion of their debentures on June 27, 2004; June 27, 2009; and June 27, 2014, at a purchase price equal to the accreted value of the debentures plus accrued and unpaid cash interest up to but not including the date of purchase. The debentures will be convertible into shares of our common stock at a conversion rate of 11.8071 shares per $0.001 initial principal amount at maturity of debentures, equivalent to an initial conversion price of $57.91 per share, if the closing price of our common stock exceeds a specified price for a specified period of time, or otherwise upon the occurrence of certain events. The debentures have an initial yield to maturity of 2.75%, including a cash payment of 1.0% and an initial accretion rate of 1.75%. The yield to maturity may be reset, but may not fall below 2.75% or above 3.75%, on Dec. 27, 2003; Dec. 27, 2008; and Dec. 27, 2013. The debentures are guaranteed on an unsecured and unsubordinated basis by Best Buy Stores, L.P., our wholly owned indirect subsidiary. The debentures, the guarantee and the underlying shares of common stock were registered with the Securities and Exchange Commission pursuant to a Registration Statement on Form S-3 that was declared effective on Oct. 9, 2001.

### Senior Subordinated Notes

Our Musicland subsidiary had $110 of Senior Subordinated Notes due in 2003 (2003 Notes) and $161 of Senior Subordinated Notes due in 2008 (2008 Notes) outstanding, which were acquired and recorded at their fair value as part of the Musicland acquisition. Fair value was based upon the present value of the amounts expected to be paid. Both notes contained change-in-control provisions that required us to offer to repurchase the notes within 30 to 60 days after our acquisition of Musicland. Our offer to repurchase both notes was made on Feb. 12, 2001, at 101.0% of the aggregate principal amount of the notes plus accrued interest. The offer expired on March 16, 2001, at which time $94 of the 2003 Notes had been tendered. In the second quarter of fiscal 2002, we retired the remainder of the 2003 notes and all but $5 of the 2008 notes.

### Credit Agreement

We have two credit agreements that provide bank revolving credit facilities under which we can borrow up to $200 and $44, respectively. The $44 facility, which was acquired in connection with the Future Shop acquisition, increases to $53 on a seasonal basis. The $200 facility, entered into in March 2002 which replaced our $100 credit agreement, expires on March 21, 2005, and the $44 facility expires in fiscal 2003. Borrowings under the $200 facility are unsecured and bear interest at rates specified in the credit agreements, as we have elected. Borrowings under the $44 facility are secured by merchandise inventories. We also pay certain facility and agent fees.

The credit agreements contain covenants that require us to maintain certain financial ratios and minimum net worth. The $200 agreement also requires that we have no outstanding principal balance for a period not less than 30 consecutive days, net of cash and cash equivalents. We had no borrowings under the $100 facility during fiscal 2002 or 2001. Future Shop had peak borrowings under the $44 credit facility of $32 and $39 in fiscal 2002 and 2001, respectively.

$ in millions, except per share amounts

### Master Lease

In the fourth quarter of fiscal 2001, we entered into a $60 master lease agreement for the purpose of constructing and leasing new retail locations. At the end of fiscal 2002, $39 in capitalized leases for new stores had been financed under the master lease agreement.

### Inventory Financing

We have a $200 inventory financing line. Borrowings are collateralized by a security interest in certain merchandise inventories approximating the outstanding borrowings. The terms of this arrangement allow us to extend the due dates of invoices beyond their normal terms. The amounts extended generally bear interest at a rate approximating the prime rate. No amounts were extended under this line in fiscal 2002 or 2001. The line has provisions that give the financing source a portion of the cash discounts provided by the manufacturers.

### Other

During fiscal 2002, 2001 and 2000, interest expense totaled $28, $7 and $5, respectively, and is included in net interest (expense) income. Fiscal 2002 interest expense includes an $8 pretax charge for the early retirement of debt. The fair value of long-term debt approximates $829, which was based primarily on quotes from external sources.

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

| **Fiscal Year** | |
|---|---|
| 2003 | $ 7 |
| 2004 | 6 |
| 2005 | 3 |
| 2006 | 40 |
| 2007 | 1 |
| Thereafter | 763 |
| | $820 |

## 4. Shareholders' Equity

### Stock Options

We currently sponsor three non-qualified stock option plans for our employees and our Board of Directors. These plans provide for the issuance of up to 73.2 million shares of common stock. Options may be granted only to employees or directors at exercise prices not less than the fair market value of our common stock on the date of the grant. The options vest over a four-year period and expire over a range of five to 10 years. In addition, there are options outstanding under two non-qualified stock option plans that expired in fiscal 1998. At March 2, 2002, options to purchase 27.5 million shares were outstanding under all of these plans.

In connection with the Musicland acquisition, certain outstanding stock options held by employees of Musicland were converted into options exercisable into our shares of common stock. These options were fully vested at the time of conversion and expire based on the remaining option term of up to 10 years. These options did not reduce the shares available for grant under any of our other option plans. The acquisition was accounted for as a purchase and, accordingly, the fair value of these options was included as a component of the purchase price using the Black-Scholes option pricing model.

*$ in millions, except per share amounts*

As permitted by SFAS No. 123, we elected to account for our stock option plans under the provisions of APB Opinion No. 25. Accordingly, no compensation cost has generally been recognized for stock options granted. Had we adopted SFAS No. 123, the pro forma effects on net earnings, basic earnings per share and diluted earnings per share for the last three fiscal years would have been as follows:

| | **2002** | **2001** | **2000** |
|---|---|---|---|
| Net earnings | | | |
| As reported | $ 570 | $ 396 | $ 347 |
| Pro forma | 512 | 352 | 322 |
| Basic earnings per share | | | |
| As reported | $1.80 | $1.28 | $1.13 |
| Pro forma | 1.62 | 1.14 | 1.05 |
| Diluted earnings per share | | | |
| As reported | $1.77 | $1.24 | $1.09 |
| Pro forma | 1.61 | 1.11 | 1.01 |

The fair value of each option was estimated on the date of the grant using the Black-Scholes option pricing model with the following assumptions:

| | **2002** | **2001** | **2000** |
|---|---|---|---|
| Risk-free interest rate | 4.9% | 6.1% | 6.4% |
| Expected dividend yield | 0% | 0% | 0% |
| Expected stock price volatility | 55% | 60% | 50% |
| Expected life of options | 4.5 years | 4.5 years | 4.5 years |

The weighted average fair value of options granted during fiscal 2002, 2001 and 2000 used in computing pro forma compensation expense was $18.60, $23.06 and $17.06 per share, respectively.

*$ in millions, except per share amounts*

Option activity for the last three fiscal years was as follows:

| | Shares | Weighted Average Exercise Price per Share |
|---|---|---|
| Outstanding on Feb. 27, 1999 | 28,708,000 | $ 6.31 |
| Granted | 4,561,000 | 34.65 |
| Exercised | (6,259,000) | 5.17 |
| Canceled | (1,441,000) | 12.99 |
| Outstanding on Feb. 26, 2000 | 25,569,000 | 11.26 |
| Granted | 8,070,000 | 45.53 |
| Assumed [1] | 461,000 | 37.21 |
| Exercised | (5,720,000) | 6.11 |
| Canceled | (2,012,000) | 26.94 |
| Outstanding on March 3, 2001 | 26,368,000 | 22.13 |
| Granted | 9,382,000 | 37.01 |
| Exercised | (6,846,000) | 6.88 |
| Canceled | (1,417,000) | 35.98 |
| Outstanding on March 2, 2002 | 27,487,000 | 30.29 |

[1] Represents Musicland options converted into Best Buy Co., Inc. options in connection with the acquisition.

*$ in millions, except per share amounts*

Exercisable options at the end of fiscal 2002, 2001 and 2000 were 9.9 million, 9.4 million and 6.9 million, respectively. The following table summarizes information concerning options outstanding and exercisable as of March 2, 2002:

| Range of Exercise Prices | Number Outstanding | Weighted Average Remaining Contractual Life (Years) | Weighted Average Exercise Price | Number Exercisable | Weighted Average Exercise Price |
|---|---|---|---|---|---|
| $ 0 to $ 6.67 | 2,880,000 | 5.29 | $ 2.08 | 2,735,000 | $ 2.19 |
| $ 6.67 to $ 13.33 | 5,476,000 | 6.15 | 11.46 | 3,186,000 | 11.45 |
| $ 13.33 to $ 20.00 | 140,000 | 7.56 | 16.42 | 56,000 | 16.28 |
| $20.00 to $ 26.67 | 76,000 | 7.62 | 21.89 | 38,000 | 21.27 |
| $26.67 to $ 33.33 | 551,000 | 7.63 | 31.02 | 265,000 | 31.61 |
| $33.33 to $ 40.00 | 11,185,000 | 8.56 | 36.41 | 1,814,000 | 35.15 |
| $40.00 to $ 46.67 | 689,000 | 9.16 | 45.34 | 73,000 | 44.18 |
| $46.67 to $ 53.33 | 6,487,000 | 8.10 | 46.87 | 1,726,000 | 46.97 |
| $53.33 to $ 60.00 | 3,000 | 8.10 | 55.09 | 1,000 | 55.09 |
| $ 0 to $ 60.00 | 27,487,000 | 7.62 | $30.29 | 9,894,000 | $20.28 |

## Restricted Stock Plan

We adopted a restricted stock award plan in fiscal 2001. The plan authorizes us to issue up to 1.5 million shares of our common stock to our eligible employees, consultants and independent contractors, as well as to our Board of Directors. Restricted shares have the same rights as other shares of common stock, except they are not transferable until fully vested. Restrictions lapse over a vesting period of at least three years, during which no more than 25% may vest at the time of award and no more than 25% on each anniversary date thereafter. All shares still subject to restrictions are forfeited and returned to the plan if the plan participant's relationship with us is terminated. The number of shares granted under this plan was not significant during fiscal 2002 or 2001.

## 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, convertible debentures assuming certain criteria are met (see note 3), and other stock-based awards granted under stock-based compensation plans. The shares related to the convertible debentures were not included in our diluted earnings per share computation as the criteria for conversion of the debentures were not met.

We completed a three-for-two stock split effected in the form of a 50% stock dividend distributed on May 10, 2002; and a two-for-one stock split effected in the form of a 100% stock dividend distributed on March 18, 1999. All share and per share information reflects these stock splits.

The following table presents a reconciliation of the numerators and denominators of basic and diluted earnings per common share for fiscal 2002, 2001 and 2000:

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| Numerator: | | | |
| Net earnings | $ 570 | $ 396 | $ 347 |
| Denominator (in millions): | | | |
| Weighted average common shares outstanding | 316.0 | 310.0 | 306.3 |
| Effect of dilutive securities: | | | |
| Employee stock options | 6.5 | 9.0 | 12.6 |
| Weighted average common shares outstanding assuming dilution | 322.5 | 319.0 | 318.9 |
| Basic earnings per share | $ 1.80 | $ 1.28 | $ 1.13 |
| Diluted earnings per share | $ 1.77 | $ 1.24 | $ 1.09 |

### Repurchase of Common Stock

In September 1999, our Board of Directors authorized the purchase of up to $200 of our common stock. This program was completed with a total of 5.7 million shares purchased and retired.

In February 2000, our Board of Directors authorized the purchase of up to $400 of our common stock from time to time through open market purchases. This program has no stated expiration date. As of March 2, 2002, 2.9 million shares had been purchased and retired at a cost of $100. No shares were repurchased in fiscal 2002 or 2001.

## 5. Operating Lease Commitments

We currently lease portions of our corporate facilities and conduct essentially all of our retail and the majority of our distribution operations from leased locations. The terms of the lease agreements generally range from three to 20 years. The leases require payment of real estate taxes, insurance and common area maintenance in addition to rent. Most of the leases contain renewal options and escalation clauses, and certain stores require contingent rents based on specified percentages of sales. In addition, certain store leases provide us an early cancellation option if sales for a designated period do not reach a specified level as defined in the lease. Other leases contain covenants related to maintenance of financial ratios. Also, we lease certain equipment under operating leases. Transaction costs associated with the sale and lease back of properties and any gain or loss are recognized over the terms of the lease agreements. Proceeds from the sale and lease back of properties are included in the net change in recoverable costs from developed properties.

*$ in millions, except per share amounts*

The composition of total rental expenses for all operating leases during the past three fiscal years, including leases of buildings and equipment, was as follows:

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| Minimum rentals | $ 518 | $299 | $227 |
| Percentage rentals | 2 | 1 | 1 |
| | $ 520 | $300 | $228 |

Future minimum lease obligations by year (not including percentage rentals) for all operating leases at March 2, 2002, were as follows:

| Fiscal Year | |
|---|---|
| 2003 | $ 472 |
| 2004 | 459 |
| 2005 | 417 |
| 2006 | 376 |
| 2007 | 361 |
| Thereafter | 2,698 |

## 6. 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 of Directors. The total matching contributions were $11, $7 and $5 in fiscal 2002, 2001 and 2000, respectively.

We have a deferred compensation plan for certain management employees and directors. The liability for compensation deferred under this plan was $33 and $28 at March 2, 2002, and March 3, 2001, respectively, and is included in long-term liabilities. We have elected to match our liability under the plan through the purchase of life insurance. The cash value of the insurance, which includes funding for future deferrals, was $36 and $34 in fiscal 2002 and 2001, respectively, and is included in other assets. Both the asset and the liability are carried at fair value.

*$ in millions, except per share amounts*

## 7. Income Taxes

The following is a reconciliation of income tax expense to the federal statutory tax rate:

| | **2002** | **2001** | **2000** |
|---|---|---|---|
| Federal income tax at the statutory rate | $328 | $224 | $197 |
| State income taxes, net of federal benefit | 35 | 27 | 23 |
| Tax-exempt interest income | (4) | (9) | (6) |
| Goodwill amortization | 6 | — | — |
| Other | 1 | 3 | 2 |
| Income tax expense | $366 | $245 | $216 |
| Effective tax rate | 39.1% | 38.3% | 38.3% |

Income tax expense consists of the following:

| | **2002** | **2001** | **2000** |
|---|---|---|---|
| Current: | | | |
| Federal | $303 | $179 | $165 |
| State | 39 | 23 | 21 |
| Foreign | 1 | — | — |
| | 343 | 202 | 186 |
| Deferred: | | | |
| Federal | 15 | 38 | 26 |
| State | 2 | 5 | 4 |
| Foreign | 6 | — | — |
| | 23 | 43 | 30 |
| Income tax expense | $ 366 | $245 | $216 |

*$ in millions, except per share amounts*

Deferred taxes are the result of differences between the basis of assets and liabilities for financial reporting and income tax purposes. Significant deferred tax assets and liabilities consist of the following:

| | March 2, 2002 | March 3, 2001 |
|---|---|---|
| Accrued expenses | $ 78 | $ 46 |
| Deferred revenues | 12 | 13 |
| Compensation and benefits | 47 | 31 |
| Inventory | 4 | 8 |
| Other | 34 | 20 |
| Total deferred tax assets | 175 | 118 |
| Property and equipment | 145 | 93 |
| Convertible debt | 5 | — |
| Other | 15 | 5 |
| Total deferred tax liabilities | 165 | 98 |
| Net deferred tax assets | $ 10 | $ 20 |

## 8. Segments

We have identified three reportable segments: Best Buy, Musicland and International. The Best Buy segment aggregates all of our operations exclusive of Musicland and International. The Best Buy segment is primarily a specialty retailer of consumer electronics, home office equipment, entertainment software and appliances. The Musicland segment is primarily a mall-based retailer of prerecorded music, movies and other entertainment-related products. Musicland was acquired in the fourth quarter of fiscal 2001. The International segment was established in connection with the acquisition of Future Shop, a specialty retailer of consumer electronics, home office equipment, entertainment software and appliances with operations in Canada. Future Shop was acquired at the beginning of November in fiscal 2002. Musicland and International financial data is included from their respective dates of acquisition.

*$ in millions, except per share amounts*

The following tables present our revenues and operating income (loss) by reportable segment for each of the past three fiscal years:

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| **Revenues** | | | |
| Best Buy | $ 17,115 | $ 15,189 | $ 12,494 |
| Musicland | 1,886 | 138 | — |
| International | 596 | — | — |
| Total revenues | $ 19,597 | $ 15,327 | $ 12,494 |
| **Operating Income (Loss)** | | | |
| Best Buy | $ 886 | $ 611 | $ 539 |
| Musicland | 29 | (7) | — |
| International | 22 | — | — |
| Total operating income (loss) | 937 | 604 | 539 |
| Net interest (expense) income | (1) | 37 | 24 |
| Earnings before income tax expense | $ 936 | $ 641 | $ 563 |

*$ in millions, except per share amounts*

**Supplemental Segment Information:**

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| **Assets** | | | |
| Best Buy | $5,672 | $3,812 | $2,995 |
| Musicland | 993 | 1,028 | — |
| International | 710 | — | — |
| Total assets | $7,375 | $4,840 | $2,995 |
| **Capital Expenditures** | | | |
| Best Buy | $ 562 | $ 657 | $ 361 |
| Musicland | 47 | 1 | — |
| International | 18 | — | — |
| Total capital expenditures | $ 627 | $ 658 | $ 361 |
| **Depreciation and Amortization** | | | |
| Best Buy | $ 238 | $ 164 | $ 104 |
| Musicland | 63 | 5 | — |
| International | 8 | — | — |
| Total depreciation and amortization | $ 309 | $ 169 | $ 104 |

## 9. Commitments and Contingencies

At the end of fiscal 2002, we had commitments for the purchase and construction of facilities valued at approximately $125.

We are involved in various legal proceedings arising during the normal course of conducting business. Management believes that the resolution of these proceedings, either individually or in the aggregate, will not have a significant adverse impact on our consolidated financial statements.