

# Management's Discussion and Analysis of Results of Operations and Financial Condition

## Overview

Best Buy Co., Inc. is North America's No. 1 specialty retailer of consumer electronics, home office equipment, entertainment software and appliances. In November of fiscal 2002, we acquired Future Shop Ltd. (Future Shop). Future Shop currently operates 95 stores and is Canada's largest specialty retailer of name-brand consumer electronics, home office equipment, entertainment software and appliances. During the fourth quarter of fiscal 2001, we acquired Musicland Stores Corporation (Musicland) and Magnolia Hi-Fi, Inc. (Magnolia Hi-Fi). Musicland is primarily a mall-based national retailer of prerecorded music, movies and other entertainment-related products with 1,321 stores. Magnolia Hi-Fi is a Seattle-based retailer of

high-end consumer electronics with 13 stores. All three acquisitions were accounted for using the purchase method. Under this method, the net assets and results of operations of those businesses are included in our consolidated financial statements from their respective dates of acquisition. We currently operate three reportable segments: Best Buy, Musicland and International. The Best Buy segment aggregates all operations exclusive of Musicland and International operations. The International segment was established in the third quarter of fiscal 2002 in connection with our acquisition of Future Shop.

Our fiscal year ended March 2, 2002, contained 52 weeks. Fiscal 2001 and 2000 contained 53 weeks and 52 weeks, respectively.

## Results of Operations

### Consolidated

The following table presents selected consolidated financial data for each of the past three fiscal years (\$ in millions, except per share amounts):

	2002	2001	Pro forma 2001 <sup>(1)</sup>	2000
Revenues	\$ 19,597	\$ 15,327	\$ 17,621	\$ 12,494
Revenues % change	28%	23%	—	24%
Comparable stores sales % gain <sup>(2)</sup>	1.9%	4.9%	4.9%	11.1%
Gross profit as a % of revenues	22.6%	20.0%	21.8%	19.2%
SG&A as a % of revenues	17.8%	16.0%	17.8%	14.8%
Operating income	\$ 937	\$ 604	\$ 703	\$ 539
Operating income as a % of revenues	4.8%	3.9%	4.0%	4.3%
Net earnings	\$ 570	\$ 396	\$ 425	\$ 347
Diluted earnings per share <sup>(3)</sup>	\$ 1.77	\$ 1.24	\$ 1.33	\$ 1.09

<sup>(1)</sup> Pro forma information reflects combined results of operations at Best Buy, Musicland and Future Shop. Musicland's results of operations are presented as if it had been acquired at the beginning of fiscal 2001 and include amortization of goodwill. Future Shop's results of operations are presented as if it had been acquired at the beginning of November in fiscal 2001 and do not include amortization of goodwill. Pro forma results are unaudited.

<sup>(2)</sup> Comparable stores are stores open at least 14 full months, include remodeled and expanded locations and, for all periods presented, reflect Best Buy stores only. Relocated stores are excluded from the comparable store sales calculation until at least 14 full months after reopening. Acquired stores will be included in the comparable store sales calculation beginning with the first full quarter following the first anniversary of the date of acquisition.

<sup>(3)</sup> The diluted earnings per share amounts above have been restated to reflect a three-for-two stock split effective on May 10, 2002.

Net earnings for fiscal 2002 increased 44%, growing to a record \$570 million, compared with \$396 million in fiscal 2001 and \$347 million in fiscal 2000. Earnings per diluted share increased to \$1.77 in fiscal 2002, compared with \$1.24 in fiscal 2001 and \$1.09 in fiscal 2000.

Our net earnings increase was primarily driven by an improved gross profit rate, new store growth, expense controls and the inclusion of operations from acquired businesses. Revenues compared with the last fiscal year's reported results grew 28%. Approximately half of the increase in revenues was due to new Best Buy stores opened in the past two fiscal years, including 62 new stores opened in fiscal 2002. The remainder of the increase was due to the inclusion of revenues from acquired businesses. The 1.9% increase in comparable Best Buy store sales was offset by the inclusion of an extra week of operations in fiscal 2001, which increased fiscal 2001 revenues by approximately \$280 million.

Our improved gross profit rate was due to increased sales of higher-margin digital products, improved supply chain management and more effective promotional strategies. In addition, the inclusion of Musicland's higher-margin sales mix increased our gross profit rate by approximately 1.1% of revenues.

Our selling, general and administrative expenses (SG&A) rate was 17.8% of revenues, an increase of 1.8% of revenues over last fiscal year. The inclusion of Musicland's higher expense structure increased our SG&A rate by approximately 1.4% of revenues. The remainder of the increase was primarily due to the impact of operating expenses increasing at a faster rate than comparable store sales, as well as increased performance-based compensation, higher depreciation expenses related to capital investments and increased charitable giving. The increase was partially offset by reduced outside consulting

costs, improved productivity and comparison with prior fiscal year expenses, which included the launch of BestBuy.com™, our entry into the New York market and the write-off of certain e-commerce investments.

Fiscal 2001 revenues were \$15.3 billion, compared with \$12.5 billion in fiscal 2000. The majority of the increase in revenues, compared with the prior fiscal year, was due to the addition of 62 Best Buy stores, a full year of operations at the 47 Best Buy stores opened in fiscal 2000 and a 4.9% comparable store sales increase at Best Buy stores. The remainder of the increase resulted from the inclusion of revenues generated by Musicland and Magnolia Hi-Fi from their dates of acquisition and the inclusion of a 53rd week that added approximately \$280 million in revenues. The Best Buy comparable store sales increase reflected the strength of the digital product cycle and benefits from our enhanced operating model that included an improved merchandise assortment, higher in-stock positions and more consistent store execution.

Gross profit in fiscal 2001 increased to 20.0% of revenues, compared with 19.2% of revenues in fiscal 2000, mainly due to improved product margins and a more profitable sales mix that resulted from increased sales of digital products and higher-end, more fully featured products. In addition, the inclusion of Musicland's higher margin sales mix increased our gross profit rate by approximately 0.2% of revenues.

Our SG&A rate increased to 16.0% of revenues in fiscal 2001, compared with 14.8% in fiscal 2000, primarily due to our increased investment in strategic initiatives and a more modest sales growth environment. In addition, the launch and operation of BestBuy.com, expenses related to our entry into the New York market and the write-off of certain e-commerce investments also impacted our SG&A rate in fiscal 2001.

In addition to traditional financial measurements, we use Economic Value Added (EVA®) to measure our financial performance and manage our allocation of capital resources. Also, a portion of executive incentive compensation is related to the achievement of targeted levels of annual EVA improvement. EVA is a financial performance measurement that includes the economic cost of assets

employed. We use EVA as one of several internal financial measures, and it is not intended to represent a measure of financial performance with respect to accounting principles generally accepted in the United States. Other organizations that use EVA as a measurement of financial performance may define and calculate EVA differently.

## Segment Performance

### Best Buy

The following table presents selected financial data for the Best Buy segment for each of the past three fiscal years (\$ in millions):

#### Segment Performance Summary<sup>(1)</sup>

(unaudited)	2002	2001	2000
Revenues	\$17,115	\$15,189	\$12,494
Comparable stores sales % gain <sup>(2)</sup>	1.9%	4.9%	11.1%
Gross profit as a % of revenues	21.2%	19.8%	19.2%
SG&A as a % of revenues	16.0%	15.8%	14.8%
Operating income	\$ 886	\$ 611	\$ 539
Operating income as a % of revenues	5.2%	4.0%	4.3%

<sup>(1)</sup> Aggregate results of our businesses other than Musicland and International.

<sup>(2)</sup> Includes only sales at Best Buy stores open at least 14 full months, and includes remodeled and expanded locations. Relocated stores are excluded from the comparable store sales calculation until they have been reopened for at least 14 full months.

Best Buy revenues for fiscal 2002 increased 13% to \$17.1 billion, compared with \$15.2 billion in fiscal 2001. Approximately half of the increase in revenues was due to new Best Buy stores opened in the past two fiscal years, including 62 new stores in fiscal 2002. The 1.9% increase in comparable Best Buy store sales was offset by the inclusion of an extra week of operations in fiscal 2001, which increased fiscal 2001 revenues by approximately \$280 million. The Best Buy comparable store sales increase was primarily the result of sales gains in the entertainment software and consumer electronics product categories, partially offset by sales declines in the home office and appliances categories. The introduction of new gaming platforms, increased availability of existing consoles and strong sales of DVD movies led to double-digit comparable store sales growth in the entertainment software category. The growth in the entertainment software category was partially offset by soft sales of prerecorded music resulting from the general absence of new releases with strong consumer appeal, an increase in the downloading of music via Internet sites and greater consumer awareness of CD recording technology. Within the consumer electronics category, digital products, including digital televisions, DVD hardware, digital cameras and digital camcorders, experienced the largest comparable store sales increases. Digital products comprised 17% of the sales mix in fiscal 2002, compared with 12% in the last fiscal year. Soft sales of desktop and configure-to-order computers as well as reduced prices for computer peripherals resulted in a comparable store sales decline in the home office product category. The decline was partially offset by increased sales of notebook computers and wireless communication devices. In the aggregate, sales of personal computers declined due to weaker consumer demand for desktop computers and challenging economic conditions. Appliance sales were soft primarily as a result of increased competition and a general slowdown in consumer demand throughout

the industry. Overall, we believe our improved supply chain management and consistent store execution also contributed to increased revenues and market share gains.

Gross profit in fiscal 2002 increased to 21.2% of revenues, up from 19.8% of revenues last fiscal year. Approximately half of the increase was due to a more profitable sales mix; the remainder of the increase was due to reduced markdowns resulting from improved supply chain management and more effective promotional strategies, as well as lower costs associated with consumer financing offers. Sales in the higher-margin consumer electronics and entertainment software product categories increased faster than sales in the home office category, which includes lower-margin personal computers. We continued to benefit from expansion in the digital product category, as margin rates on digital products typically are higher than on analog products. Inventory turns for Best Buy stores declined slightly to 7.5 times in fiscal 2002, compared with last fiscal year's 7.6 times, due to a sales mix shift from faster-turning computers to consumer electronics, improved in-stock positions and modest comparable store sales growth. Lower costs associated with consumer financing offers resulted from reduced interest rates and more favorable terms related to a new private-label credit card agreement.

Our SG&A rate increased to 16.0% of revenues in fiscal 2002, compared with 15.8% in the prior fiscal year. The increase was primarily due to expenses associated with less mature stores, the deleveraging effect of modest comparable store sales growth, increased performance-based compensation expense related to our 44% increase in net earnings and increased depreciation expense resulting from capital investments in new Best Buy stores and core financial and operating systems. We also increased our charitable giving in fiscal 2002. Our increased expenses were partially offset by reduced advertising expenditures as a percentage of revenues,

improved productivity and comparison with prior fiscal year expenses, which included the launch of BestBuy.com, our entry into the New York market and the write-off of certain e-commerce investments. In addition, our focus on controlling expenses, such as corporate hiring and outside consulting costs, positively impacted our SG&A rate. Overall, the results of operations at Magnolia Hi-Fi did not significantly impact the Best Buy segment's financial results.

During fiscal 2002, we opened 62 new Best Buy stores, including 20 stores in our 30,000-square-foot format. The openings brought our total to 481 stores, compared with 419 stores at the end of fiscal 2001. In addition, we remodeled three Best Buy stores and expanded two Best Buy stores during fiscal 2002, compared with no remodeled stores and two expanded stores in fiscal 2001. Magnolia Hi-Fi continued to operate 13 stores, unchanged from fiscal 2001.

## Musicland

The following table presents selected financial data for the Musicland segment for each of the past two fiscal years (\$ in millions):

### Segment Performance Summary

(unaudited)	2002	Pro forma 2001 <sup>(1)</sup>
Revenues	\$1,886	\$1,915
Comparable stores sales % change <sup>(2)</sup>	(0.9%)	(0.7%)
Gross profit as a % of revenues	35.0%	36.9%
SG&A as a % of revenues	33.5%	32.9%
Operating income	\$ 29	\$ 77
Operating income as a % of revenues	1.6%	4.0%

<sup>(1)</sup> Pro forma results of operations at Musicland, including the amortization of goodwill, as though it had been acquired at the beginning of fiscal 2001.

<sup>(2)</sup> Includes sales at Musicland stores open at least 12 months. Relocated stores are included in the comparable store sales calculation.

For fiscal 2002, Musicland revenues were \$1.9 billion, slightly lower than last year's pro forma results. Comparable store sales decreased 0.9% for the fiscal year primarily due to reduced mall traffic and softness in sales of prerecorded music and VHS movies. The comparable store sales decline was partially offset by increased sales of DVD movies and the introduction of new gaming hardware and software.

Musicland's fiscal 2002 gross profit margin of 35.0% of revenues declined by 1.9% of revenues compared with last year's pro forma results. The decline was primarily due to a change in the product mix, including soft sales of prerecorded music and increased sales of lower-margin DVD movies and gaming hardware and software.

The SG&A rate was 33.5% of revenues in fiscal 2002 compared with a pro forma rate of 32.9% last fiscal year. The SG&A rate increase was primarily the result of the deleveraging impact of the comparable store sales decline, higher distribution costs and increased expenses associated with the remerchandising of Sam Goody stores,

partially offset by reduced advertising expenditures. In addition, both fiscal 2002 and pro forma 2001 included approximately \$16 million of goodwill amortization. Goodwill amortization will cease at the beginning of fiscal 2003 with our adoption of SFAS No. 142, *Goodwill and Other Intangible Assets*.

## International

The following table presents selected financial data for the International segment for each of the past two fiscal years (\$ in millions):

### Segment Performance Summary

(unaudited)	2002 <sup>(1)</sup>	Pro forma 2001 <sup>(2)</sup>
Revenues	\$596	\$543
Comparable stores sales % gain <sup>(3)</sup>	17.4%	—
Gross profit as a % of revenues	23.4%	24.3%
SG&A as a % of revenues	19.7%	21.4%
Operating income	\$ 22	\$ 16
Operating income as a % of revenues	3.7%	2.9%

<sup>(1)</sup> Results of operations at Future Shop since its acquisition at the beginning of November fiscal 2002.

<sup>(2)</sup> Pro forma information presents the results of operations of Future Shop as though it had been acquired at the beginning of November fiscal 2001.

<sup>(3)</sup> Includes sales at Future Shop stores open at least 14 full months, and includes remodeled and expanded locations. Relocated stores are excluded from the comparable store sales calculation until they have been reopened for at least 14 full months. The comparable store sales calculation excludes the impact of foreign currency exchange rate fluctuations.

Future Shop revenues were \$596 million in fiscal 2002, a 10% increase compared with last year's pro forma results. For the year, comparable store sales increased 17.4%, before the impact of foreign currency exchange rate fluctuations. The comparable store sales gains were driven by increased sales of entertainment software products and consumer electronics, which includes the rapidly expanding digital product category.

In fiscal 2002, Future Shop's gross profit was 23.4% of revenues, a decrease of 0.9% of revenues compared with last year's pro forma results. The decline was mainly due

to a shift in the sales mix driven by increased sales of lower-margin entertainment software products. The impact of the sales mix shift was partially offset by lower costs associated with consumer financing offers due to lower interest rates and more favorable terms related to a new private-label credit card agreement.

For the year, the SG&A rate was 19.7% of revenues, compared with 21.4% of revenues last year, on a pro forma basis. Increased leverage resulting from strong comparable store sales gains and controlled expenses contributed to the SG&A rate decrease.

## Consolidated Results

### Net Interest (Expense) Income

Net interest expense was \$1 million in fiscal 2002, compared with net interest income of \$37 million last fiscal year. Fiscal 2002 included an \$8 million pre-tax charge from the early retirement of debt acquired as part of the Musicland acquisition. The balance of the change in net interest resulted primarily from lower yields on short-term investments as the average interest rate declined by more than 2% compared with last fiscal year. The impact of lower short-term investment yields was partially offset by higher average cash balances resulting from strong operating cash flows and net proceeds from the issuance of convertible debentures.

Net interest income increased to \$37 million in fiscal 2001 compared with \$24 million in fiscal 2000. The increase was due to higher cash balances compared with the prior fiscal year. The higher cash balances were the result of cash flows generated from operations, including improved inventory management and a \$200 million investment in Best Buy common stock by Microsoft Corporation as part of a strategic alliance. Interest expense on Musicland debt and lost interest income on the cash used to acquire Musicland and Magnolia Hi-Fi reduced net interest income by approximately \$4 million.

### Effective Income Tax Rate

Our effective income tax rate increased to 39.1%, up from 38.3% last fiscal year. The increase in the effective income tax rate was primarily due to the nondeductibility of goodwill amortization expense resulting from our acquisitions in the fourth quarter of fiscal 2001.

Our effective income tax rate in fiscal 2001 was 38.3%, unchanged from fiscal 2000. Historically, our effective tax rate has been impacted primarily by the taxability of investment income and state income taxes.

## Liquidity and Capital Resources

### Summary

We improved our financial position in fiscal 2002 while continuing to make significant investments in new growth initiatives, including the \$377 million, or \$368 million net of cash acquired, acquisition of Future Shop. Cash and cash equivalents increased to \$1.9 billion at the end of fiscal 2002, compared with \$747 million at the end of fiscal 2001. Working capital, the excess of current assets over current liabilities, increased to \$881 million at the end of fiscal 2002, compared with \$214 million at the end of fiscal 2001. In fiscal 2002, strong operating cash flows and net proceeds from the issuance of convertible debentures strengthened our liquidity position; however, our long-term debt-to-capitalization ratio increased to 24% at the end of fiscal 2002, compared with 9% at the end of fiscal 2001.

### Cash Flows

Cash provided by operating activities was \$1.6 billion in fiscal 2002, compared with \$808 million in fiscal 2001 and \$776 million in fiscal 2000. The increase in operating cash flows in fiscal 2002, compared with the prior fiscal year, was driven by increased net earnings and cash generated from changes in net operating assets and liabilities. The changes were related to increased accounts payable balances due to higher business volume and timing of invoice payments, as well as increased accrued income taxes. In addition, other liabilities increased due to business growth, advances received under vendor alliances, increased gift card liabilities and higher accrued performance-based compensation expenses resulting from our improvement in net earnings. The changes were partially offset by increased ending inventory, which resulted from the operations of 62 new Best Buy stores and improved in-stock levels.

Net cash used in investing activities in fiscal 2002 was \$965 million, compared with \$1.0 billion and \$416 million



in fiscal 2001 and 2000, respectively. In fiscal 2002, cash was used for business acquisitions, construction of new retail locations, information systems improvements and other additions to property, plant and equipment, including construction of a new corporate headquarters and expansion of our distribution facilities. The primary purpose of the cash investment activity was to support our expansion plans, improve our operational efficiency and enhance shareholder value. Strong operating cash flows more than offset cash used to fund our business expansion plans, construct new stores and fund strategic initiatives.

In fiscal 2002 and 2001, net cash provided by financing activities was \$495 million and \$218 million, respectively, while \$395 million was used in financing activities in fiscal 2000. We raised \$726 million, net of offering expenses, through the issuance of convertible debentures in fiscal 2002. The proceeds of the issuance will be used for general corporate purposes. Favorable market conditions were also a factor in the decision to issue convertible debentures. In addition, we retired \$266 million in Senior Subordinated Notes due 2003 and 2008 acquired as part of the Musicland acquisition. Fiscal 2001 included a \$200 million investment by Microsoft Corporation in our common stock. For more information regarding the convertible debentures and retirement of debt, refer to note 3 of the Notes to Consolidated Financial Statements on page 43.

## Sources of Liquidity

Funds generated by operations and existing cash and cash equivalents continue to be our most significant sources of liquidity. We currently believe funds generated from the expected results of operations and available cash and cash equivalents will be sufficient to finance anticipated expansion plans and strategic initiatives for the next fiscal year. In addition, our revolving credit facility is available for additional working capital needs or

investment opportunities. Our liquidity is not currently dependent on the use of off-balance sheet financing arrangements other than operating leases.

We have a \$200 million unsecured revolving credit facility scheduled to mature in March 2005 and, as a result of the Future Shop acquisition, a \$44 million secured revolving credit facility that will expire in fiscal 2003. The \$44 million facility increases to \$53 million on a seasonal basis. We also have a \$200 million inventory financing line. Borrowings under this line are collateralized by a security interest in certain merchandise inventories approximating the outstanding borrowings. We received no advances under the \$200 million credit facility or the inventory financing line in fiscal 2002 or 2001. Future Shop had peak borrowings under the \$44 million credit facility of \$32 million and \$39 million in fiscal 2002 and 2001, respectively.

Our credit ratings as of March 2, 2002, were as follows:

Rating Agency	Rating	Outlook
Fitch	BBB	Stable
Moody's	Baa3	Stable
Standard & Poor's	BBB-	Negative

Factors that can impact our credit rating include changes in the economic environment, conditions in the retail and consumer electronics industries, our financial position and changes in our business strategy. We do not currently foresee any reasonable circumstances under which our credit rating would be significantly downgraded. However, if a significant downgrade were to occur, it could adversely impact, among other things, our future borrowing costs, access to capital markets, vendor financing terms and future new store operating lease costs. In addition, the conversion rights of the holders of our convertible debentures could be accelerated if our credit rating were to be downgraded.



## Contractual Obligations and Available Commercial Commitments

The following table presents information regarding contractual obligations by fiscal year (\$ in millions):

### Contractual Obligations

	<b>Payments Due</b>					
	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>Thereafter</b>
Operating leases	\$472	\$459	\$417	\$376	\$361	\$2,698
Long-term debt	7	6	3	40	1	763
Purchase commitments	120	5	—	—	—	—
Total	\$599	\$470	\$420	\$416	\$362	\$3,461

Note: For more information regarding operating leases, long-term debt and purchase commitments, refer to notes 3, 5 and 9, respectively, in the Notes to Financial Statements beginning on page 39.

The following table presents information regarding available commercial commitments and their expiration dates by fiscal year (\$ in millions):

### Available Commercial Commitments

		Expires				
	Amount	2003	2004	2005	2006	Thereafter
Lines of credit <sup>(1)</sup>	\$ 222	\$ 31	\$ —	\$ —	\$ 191	\$ —
Master lease agreement	23	—	—	—	23	—
Inventory financing line	200	200	—	—	—	—
Total	\$ 445	\$ 231	\$ —	\$ —	\$ 214	\$ —

<sup>(1)</sup> Our \$44 million revolving credit facility increases to \$53 million on a seasonal basis. Nine million dollars of our \$200 million line of credit were committed to stand-by letters of credit.

## Debt and Capital

In fiscal 2002, we completed two private offerings of convertible debentures due June 27, 2021, and Jan. 15, 2022, respectively, with a combined initial principal amount at maturity of \$894 million. The proceeds from the offerings, net of offering expenses, were \$726 million. We may redeem, and holders of the debentures may require us to purchase, all or part of the debentures on certain dates or upon the occurrence of certain events as specified in the respective agreements. In addition, in the event that certain conditions are satisfied, holders may surrender their debentures for conversion, which would increase the number of shares of our common stock outstanding and have a dilutive impact on our reported earnings per share.

For additional information regarding the convertible debentures, refer to note 3 of the Notes to Consolidated Financial Statements on page 43.

Our ability to access our credit facilities is subject to our compliance with the terms and conditions of the credit facilities, including financial covenants. The financial covenants require us to have minimum earnings before interest, taxes, depreciation and amortization (EBITDA), and a minimum net worth, as well as to maintain other financial ratios. As of the end of fiscal 2002, we were in compliance with all such covenants. In addition, in the event we were to default on any of our other debt, it would constitute default under our credit facilities as well.

Our current practice is to lease rather than own real estate. For those sites developed using working capital, we generally sell and lease back those properties under long-term lease agreements. In fiscal 2002, recoverable costs from the developed properties decreased \$25 million

compared with the prior fiscal year as we sold properties to unrelated third parties and leased them back under operating leases. In addition, in fiscal 2002 we utilized a \$60 million master lease facility to finance new store development. Expenditures for stores developed under this financing facility are recorded on the balance sheet as property under capital lease with a corresponding lease obligation liability. At the end of fiscal 2002, \$39 million in capitalized leases related to new stores had been financed under the master lease agreement.

In fiscal 2000, our Board of Directors authorized the purchase of up to \$400 million of our common stock from time to time through open-market purchases. The stock purchase program has no stated expiration date. Approximately 2.9 million shares were purchased under this plan during fiscal 2000 at a cost of \$100 million. No additional purchases were made in fiscal 2002 or 2001.

## Significant Accounting Policies

### Revenue Recognition

We recognize revenues from the sale of merchandise at the time the merchandise is sold. Service revenues are recognized at the time the service is provided, the sale 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.

## **Inventory Reserves**

We maintain inventory at the lower of cost or market. Markdown reserves are established based primarily on forecasted consumer demand, inventory aging and technological obsolescence. If our estimates regarding consumer demand are inaccurate or changes in technology impact demand for certain products in an unforeseen manner, we could be exposed to losses in excess of our established reserves.

Independent physical inventory counts are taken on a regular basis at all locations that hold inventory to ensure the amounts reflected in our consolidated financial statements are properly stated. During the interim period between physical inventory counts, we accrue for anticipated physical inventory losses on a location-by-location basis, based on historical results and current trends. If our estimates regarding physical losses are inaccurate, we could be exposed to losses in excess of our established reserves.

## **Long-Lived Assets**

Long-lived assets such as property, plant and equipment; goodwill; software; and investments are reviewed for impairment when events or changes in circumstances indicate the carrying value of the assets may not be recoverable. We would recognize an impairment loss when estimated future undiscounted cash flows expected to result from the use of the asset and its value upon disposal are less than its carrying amount. If our estimates regarding future undiscounted cash flows or useful lives were to change, we could be exposed to losses that are material in nature.

## **Tax Contingencies**

Domestic and foreign tax authorities frequently audit us. These audits include questions regarding the timing and amount of deductions and the allocation of income among

various tax jurisdictions. In evaluating the exposure associated with our various filing positions, we record reserves for probable exposures. To the extent we prevail in matters for which accruals have been established or are required to pay amounts in excess of our reserves, our effective tax rate in a given financial statement period may be materially impacted. As of the end of fiscal 2002, three and two of our open tax years were undergoing examination by the United States Internal Revenue Service and Revenue Canada, respectively.

## **New Accounting Pronouncements**

A discussion of recently issued accounting pronouncements is described in note 1 of the Notes to Consolidated Financial Statements on page 39.

## **Outlook for Fiscal 2003**

Looking forward to fiscal 2003, we are projecting earnings growth of approximately 18% to 21% from \$1.77 per share in fiscal 2002 to approximately \$2.10 to \$2.17 per share in fiscal 2003. We expect the earnings growth to be driven by a 17% to 20% increase in revenues, maintaining the gross profit rate we delivered in fiscal 2002 and modestly reducing our SG&A rate. The projected earnings increase reflects a reduction in Musicland's operating income from \$29 million in fiscal 2002 to approximately break-even in fiscal 2003 due to continued transformation initiatives. The reduction in Musicland's operating income is net of the \$16 million decrease in Musicland's goodwill amortization expense as a result of adopting SFAS No. 142, *Goodwill and Other Intangible Assets*, at the beginning of fiscal 2003. In addition, our projections assume that the U.S. economy will continue to gradually improve in fiscal 2003.

We expect total revenues to grow from \$19.6 billion in fiscal 2002 to between \$23.0 billion and \$23.5 billion

in fiscal 2003 due to new store growth, comparable store sales gains and the inclusion of a full year of Future Shop revenues. In fiscal 2003, comparable store sales are expected to increase by approximately 3% to 4%.

In fiscal 2003, our gross profit rate is expected to remain essentially even with the fiscal 2002 rate based on anticipated gross profit rate improvement at Best Buy stores and International, offset by a planned gross profit rate decline at Musicland. The anticipated gross profit rate improvement at Best Buy stores and International is based on a more profitable sales mix resulting from an increase in sales of higher-margin digital products. However, the rate of improvement is likely to be less than experienced in the prior fiscal year, as these and other products become more widely distributed through mass merchandisers and discount chains. Musicland's planned gross profit rate decline in fiscal 2003 is due to the continued shift in the sales mix from higher-margin sales of prerecorded music to lower-margin sales of DVD movies and video gaming.

Our SG&A rate is expected to decrease modestly in fiscal 2003. The expected decrease is due to expense leverage, primarily in the second half of our fiscal year, as a result of the anticipated increase in comparable store sales and the expanding store base. The SG&A rate decline resulting from increased expense leverage will be partially offset by higher depreciation expenses related to our increased levels of capital spending in fiscal 2003 and higher medical coverage costs for our employees.

We anticipate net interest income for fiscal 2003 of approximately \$6 million, consistent with fiscal 2002, excluding the \$8 million pre-tax charge from the early retirement of debt incurred in the second quarter of fiscal 2002.

Our effective tax rate is expected to decrease modestly in fiscal 2003 as a result of the discontinued amortization of nondeductible goodwill.

We expect fiscal 2003 capital expenditures to be approximately \$1 billion, exclusive of amounts expended on property development that will be recovered through the sale and lease back of the properties. The capital spending will support the opening of approximately 60 Best Buy stores in the United States and six to eight in Canada, 30 small-market Sam Goody stores, eight to nine Future Shop stores and six Magnolia Hi-Fi stores. About half of the new U.S. Best Buy stores are expected to be 45,000-square-foot, Concept 5 store formats, and the other half are expected to be 30,000-square-foot, smaller market Concept 5 store formats. In addition, fiscal 2003 capital spending will support the continued development of our information systems and infrastructure, the continued construction of our new corporate headquarters and the transformation and integration of Musicland and Future Shop stores.

Beginning in the first quarter of fiscal 2003, we will report two segments, Domestic and International. The Domestic segment will be comprised of operations at Best Buy's U.S., Musicland and Magnolia Hi-Fi stores. The International segment will be comprised of Best Buy's Canadian and Future Shop operations. The primary reasons for this change are the significant similarities of their respective products and markets, the leveraging of our buying and distribution functions and the merging of many of our operational functions into a shared services model in the first quarter of fiscal 2003.

## Quarterly Results and Seasonality

Similar to many retailers, our business is seasonal. Revenues and earnings are typically greater during the second half of the fiscal year, which includes the holiday selling season. The timing of new store openings, costs associated with acquisitions and development of new businesses, and general economic conditions also may affect our future quarterly results.

The following tables show selected unaudited quarterly operating results and high and low prices of our common stock for each quarter of fiscal 2002 and 2001.

(\$ in millions, except per share amounts)

<b>Quarter</b> <sup>(1) (2)</sup>	<b>1st</b>	<b>2nd</b>	<b>3rd</b>	<b>4th</b>
Fiscal 2002				
Revenues	\$3,697	\$4,164	\$4,756	\$6,980
Comparable store sales change <sup>(3)</sup>	(3.1%)	2.8%	1.6%	4.5%
Gross profit	\$ 846	\$ 948	\$1,028	\$1,608
Operating income	90	148	129	570
Net earnings	55	85	80	350
Diluted earnings per share <sup>(4)</sup>	.17	.26	.25	1.08
Fiscal 2001				
Revenues	\$2,964	\$3,169	\$3,732	\$5,462
Comparable store sales change <sup>(3)</sup>	9.5%	5.1%	5.9%	1.8%
Gross profit	\$ 606	\$ 648	\$ 689	\$1,116
Operating income	109	115	85	295
Net earnings	72	77	57	190
Diluted earnings per share <sup>(4)</sup>	.23	.24	.18	.60

<sup>(1)</sup> During the third quarter of fiscal 2002, we acquired the common stock of Future Shop Ltd. Future Shop's results of operations were included from the date of acquisition.

<sup>(2)</sup> The fourth quarter of fiscal 2001 included 14 weeks. All other quarters included 13 weeks. Also, during the fourth quarter of fiscal 2001, we acquired the common stock of Musicland Stores Corporation and Magnolia Hi-Fi, Inc. The results of operations of those businesses were included from their dates of acquisition.

<sup>(3)</sup> Best Buy stores only. The comparable store sales increase for the fourth quarter of fiscal 2002 was based upon the comparable 13-week period for the prior fiscal year. The comparable store sales increase for the fourth quarter of fiscal 2001 was based upon the comparable 14-week period for the prior fiscal year.

<sup>(4)</sup> The diluted earnings per share amounts above have been restated to reflect a three-for-two stock split, effective on May 10, 2002.

## Common Stock Prices

Quarter	1st	2nd	3rd	4th
Fiscal 2002				
High	\$41.57	\$46.60	\$48.00	\$51.47
Low	22.42	35.45	26.68	43.43
Fiscal 2001				
High	\$59.25	\$53.79	\$49.42	\$34.00
Low	31.50	38.33	20.33	14.00

Our common stock is traded on the New York Stock Exchange under the ticker symbol BBY. As of March 28, 2002, there were 2,013 holders of record of Best Buy common stock. We have not historically paid, and have no current plans to pay, cash dividends on our common stock. The stock prices above have been restated to reflect a three-for-two stock split, effective on May 10, 2002.

## Forward-Looking Statements

Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, provide a “safe harbor” for forward-looking statements to encourage companies to provide prospective information about their companies. With the exception of historical information, the matters discussed in this annual report are forward-looking statements and may be identified by the use of words such as “believe,” “expect,” “anticipate,” “plan,” “estimate,” “intend” and “potential.” Such statements reflect our current view with respect to future events and are subject to certain risks, uncertainties and assumptions. A variety of factors could cause our actual

results to differ materially from the anticipated results expressed in such forward-looking statements, including, among other things, general economic conditions, acquisitions and development of new businesses, product availability, sales volumes, profit margins, weather, foreign currency fluctuation, availability of suitable real estate locations, and the impact of labor markets and new product introductions on our overall profitability. Readers should review our Current Report on Form 8-K filed May 16, 2001, which describes additional important factors that could cause actual results to differ materially from those contemplated by the forward-looking statements made in this annual report.