



Borders Group, Inc. Annual Report 2005

Proxy Statement | Form 10-K

annual report 2005
proxy statement
form 10-K

BORDERS
Group

100 Phoenix Drive
Ann Arbor, MI 48108
www.bordersgroupinc.com

BORDERS
Group



Borders Group, Inc. is a leading global retailer of books, music, movies, and gifts and stationery items, as well as an operator of fine specialty coffee cafes.

At the close of 2005, we operated 473 Borders® superstores in the U.S.; 55 Borders® International superstores, located primarily in the U.K. and Asia Pacific; 33 Books etc. stores throughout Great Britain; and 678 stores within our Waldenbooks Specialty Retail segment, which includes Waldenbooks®, Borders Express®, Borders OutletSM, and Borders® airport stores.

In addition, Borders Group owns and operates London-based Paperchase Products Limited, a designer and retailer of innovative stationery, greeting cards, gift packaging, and other items. Paperchase operates 90 stores, primarily in the U.K., and Paperchase® shops have been added to nearly 100 U.S. Borders superstores.

Teamed with Amazon.com, online shopping is available through www.borders.com. More information about the company can be found at www.bordersgroupinc.com.

corporate headquarters

Borders Group, Inc.
100 Phoenix Drive | Ann Arbor, MI 48108 | 734.477.1100

independent registered public accounting firm

Ernst & Young, LLP
500 Woodward Avenue | Detroit, MI 48226

registrar and stock transfer agent

Computershare Trust Company, NA
P.O. Box 43069 | Providence, RI 02940-3069 | 800.446.2617

common stock

The Company's Common Stock trades on the New York Stock Exchange under the symbol BGP.

annual meeting

Borders Group, Inc.'s annual meeting of stockholders will be held on May 25, 2006, 11:30 am local time at: The Westin Detroit Metropolitan Airport | 2501 WorldGateway Place Detroit, MI 48242

stockholders' inquiries

For information about Borders Group, Inc. and its subsidiaries, including Annual Reports, Form 10-K and 10-Q documents, and other available financial information, please send your request to: Borders Group, Inc. | Investor Relations | 100 Phoenix Drive Ann Arbor, MI 48108 | phone 734.477.1794 | fax 734.477.1517 Information can also be obtained online by visiting www.bordersgroupinc.com

market price for common stock

The following table sets forth, for the fiscal quarters indicated, the high and low closing market prices for the Company's Common Stock. As of March 28, 2006, there were approximately 3,154 holders of record of the Company's Common Stock. This number excludes individual stockholders holding stock under nominee security position listings.

| 2005 | high | low | 2004 | high | low |
|------|---------|---------|------|---------|---------|
| Q1 | \$27.47 | \$23.59 | Q1 | \$25.21 | \$21.27 |
| Q2 | \$26.20 | \$23.92 | Q2 | \$24.94 | \$22.09 |
| Q3 | \$25.30 | \$18.96 | Q3 | \$25.22 | \$21.42 |
| Q4 | \$24.70 | \$18.71 | Q4 | \$26.30 | \$21.95 |

additional information

The Company's Form 10-K Annual Report for the fiscal year ended January 28, 2006, is being delivered to shareholders with this Annual Report and should be read in conjunction with it. Information in the Form 10-K Annual Report, including the Company's Financial Statements and other financial information, Management's Discussion and Analysis of Financial Condition and Results of Operations, and disclosure regarding market risk, is important to an understanding of the Company and is incorporated herein by reference.

The Company has filed with the Securities and Exchange Commission, as an exhibit to its Form 10-K Reports for fiscal 2004 and 2005, the Sarbanes-Oxley Act Section 302 Certifications regarding the quality of the Company's public disclosure. During 2005, Mr. Josefowicz certified to the New York Stock Exchange that he was not aware of any violation by the Company of any NYSE Corporate Governance Listing Standards.

safe harbor statement

This report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. One can identify these forward-looking statements by the use of words such as "expect," "continue," "goal," "plan," "will," "anticipate," and other words of similar meaning. One can also identify them by the fact that they do not relate strictly to historical or current facts. These statements are likely to address matters such as the Company's future financial performance (including sales and earnings guidance); its plans and expected benefits relating to store openings, closings, and remodels; the addition of the Seattle's Best Coffee and Paperchase brands to new and certain remodeled stores; and its intentions with respect to dividend payments and share repurchases. These statements are subject to risks and uncertainties that could cause actual results to differ materially from the Company's forward-looking statements. Please refer to the Company's annual, quarterly, and periodic reports on file with the Securities and Exchange Commission for a detailed discussion of such risks and uncertainties. The Company does not undertake any obligation to update forward-looking statements.



It was a year of balancing priorities for Borders Group in 2005, as we made the strategic decision to increase capital investments to strengthen the foundation of our business and to fund new growth opportunities. As we stepped up these investments—which carried a physical cost and created a temporary disruption in our business—we also encountered a challenging period in our industry and in segments of the global retail environment.

As a result, Borders Group fell short of what we planned to achieve as consolidated sales improved modestly, growing 3.9% to \$4.0 billion, while earnings per share declined by 16.0% to \$1.42. Yet, what these numbers don't illustrate is that 2005, with all its investments and challenges, also provided critical confidence that we have the right strategy in place for long-term growth. Let me explain why.

Taking a closer look at our numbers

As I said, we faced some headwinds in 2005. For starters, it was a lackluster year for books, as bookstore sales industry-wide decreased by 1.0% according to U.S. Census Bureau estimates. The music industry also continued its steep decline, and our company was significantly impacted by a difficult retail environment in the U.K., where we generate approximately three-quarters of our International segment sales.

While managing these challenges, we were also investing for the future, creating short-term hurdles of our own. In addition to building new stores, both domestically and internationally, we remodeled existing stores to improve their productivity. We refined marketing and promotional programs to increase traffic and enhanced customer service to convert more of those visits into sales.

The downside: Combined, these internal and external factors put significant pressure on our first three quarters of performance, as we recorded a loss of \$0.25 per share for the period compared to earnings of \$0.12 per share in 2004. The upside: We learned where capital is best deployed to drive long-term results, and in the fourth quarter, we began to see the benefits of investments made in Borders. Highlights for the fourth quarter included:

- Consolidated sales rose 6.3% to \$1.5 billion.
- Consolidated earnings per share increased 9.9% to \$1.78.
- Borders domestic superstores led these gains, as sales improved 9.8% to \$938.7 million.



Gregory P. Josefowicz

Chairman, President
& Chief Executive Officer



- Comparable store sales at domestic superstores improved 2.5%. For the year, domestic superstore comp sales grew 1.1%, and we continued to increase market share.
- Our strong focus on books generated equally strong results as domestic Borders superstores achieved a 6% same-store increase in books during the fourth quarter.
- New stores and store remodels boosted sales in the cafe and gift and stationery categories, reinforcing our plan to use these growing and high margin categories to help offset declining music sales trends.

While we still have a lot of work to do, we believe these positive fourth quarter achievements confirm that we're on the right track. We will continue to advance our business plan, using what we've learned to refine remodel efforts, expand our domestic and international presence, deploy increasingly effective promotional programs, extend our "single brand" initiative, and create the best possible shopping experience for our customers.

Remodels boost sales of key categories

Per our business plan, we remodeled approximately 100 Borders superstores in the U.S. during fiscal 2005, enhancing the in-store presentation of our core book category, introducing more Seattle's Best Coffee® cafes, and launching new Paperchase® gift and stationery shops. In addition to helping to differentiate our stores, these improvements give shoppers more reasons to visit Borders stores on a regular basis, while concentrating our investments on the fastest-growing and high margin areas of our business.

Customers have responded positively to these efforts, increasing comparable store sales in our key book, cafe, and gift and stationery categories. We will focus a majority of our investments on these successful categories during fiscal 2006, as we plan to remodel up to 100 additional stores to varying degrees. By the 2006 holiday season, approximately half of our domestic superstores will be upgraded, including Paperchase shops, and nearly two-thirds of our stores will include Seattle's Best Coffee cafes.

Expanding our domestic and international presence

Applying these same in-store design concepts, we opened 15 new domestic superstores during fiscal 2005. These new locations delivered higher first-year sales productivity than stores opened in recent years. We plan to increase our new store openings in 2006, targeting approximately 35 new U.S. locations by year-end.



Fifteen new International stores were opened in 2005, including the first two Borders franchise stores, which are located in Malaysia. Total International sales increased 12.9% in 2005 compared to a 25% gain the previous year. This result is primarily attributable to the difficult economic environment in the U.K., which we believe is temporary and will not impact our future growth plans. Outside of the U.K., results continued to be strong, particularly in Asia Pacific.

We remain firmly committed to our global expansion strategy and in March 2006 named a new chief executive for our U.K. operations, strengthening the management team. Our plan for the International segment in 2006 includes opening 12 to 14 new stores, primarily where we already have a presence, and we'll also continue new market expansion.

Launching a rewarding new loyalty program

Among the keys to our fourth quarter success: We used targeted e-mail promotions more effectively to increase store traffic and sales. We will continue to refine and expand these promotions in 2006, as we seek more efficient ways to reach our customers with compelling reasons to visit our stores more often.

Our new Borders RewardsSM loyalty program, launched in February 2006, is one of the cornerstones of this effort. This program, designed to be particularly compelling when compared with competing programs, provides many unique benefits. First and foremost, the program is free for customers. And, members earn rewards every time they shop at any Borders, Borders Express, Borders Outlet, Borders airport, and Waldenbooks store throughout the U.S.

I encourage you to become a Borders Rewards member. Just pick up a card at your neighborhood store to begin earning savings immediately. Then, register your card online at www.bordersrewards.com and gain even more program advantages.

Extending our “single brand” strategy

Borders Rewards is just one component of our growing single brand strategy designed to leverage the recognition and value of the Borders brand across our entire enterprise and to improve the operating effectiveness of our businesses.

To maximize this effort, we reorganized our internal structure at the close of 2005, creating a single management team for all of our domestic stores. At the same time, we also began rolling out a new advanced merchandising system, which ultimately will unite the technology platform shared by all business segments and improve our national distribution and logistics network. In 2006, we will continue to strengthen our infrastructure by further investment in the merchandising system and by opening a new full-service distribution center in Carlisle, Pennsylvania.



As part of our single brand strategy, we converted 98 Waldenbooks stores to Borders Express stores during 2005, making modest investments to improve store layout and merchandise selection. These Borders Express stores performed well relative to an overall 4.5% decrease in sales within the Waldenbooks Specialty Retail segment. We continue to manage this segment rationally, focusing on improving operations, closing poorly performing stores as necessary, and converting to Borders Express in markets that make sense. During 2005, we also opened five new Borders airport stores and continued to advance our seasonal mall calendar and Borders Outlet store businesses.

Creating the ideal shopping experience for our customers

In addition to enhancing our stores, we are investing in training and advancement programs for our people, so they can deliver the best possible shopping experience for our customers. We are also improving our in-store technology, expanding Borders Search interactive self-service computer stations to include special order capabilities, a Borders Rewards registration and tracking feature, and other functions such as music listening.

Led by our store employees, who continue to distinguish themselves by displaying intense focus and effective execution, we have launched a companywide *"We Are All Booksellers"* initiative. This rallying point reminds all Borders Group employees everywhere—from the corporate headquarters to our distribution centers to stores around the globe—that it is everyone's responsibility to make Borders stores the world's preferred destination for books.

Maintaining our commitment to shareholder returns

We ended fiscal 2005 with a strong balance sheet, as total debt increased only modestly to support increases in capital expenditures and share repurchases. During the year, we bought back 11.6 million shares of stock, totaling \$265.9 million, and our Board of Directors approved up to \$250 million in additional stock repurchases at its meeting in January 2006. Earlier, the Board voted to increase our quarterly cash dividend by 11% to \$0.10 per share, our second increase since instituting a dividend in 2003.

As announced in January 2006, I will retire from my position as President, Chairman, and CEO of Borders Group within the next two years. I will remain in my current role until the Board of Directors names a successor, and after that, will serve the company as the Board deems appropriate until the end of 2007. This process is highly disciplined and follows our established succession planning path for an orderly transition. During this time, I will remain focused and completely committed to executing our business plan. I appreciate the continued support of the Borders Group management team, employees, and vendors as we move forward together.



To sum up our plans, fiscal 2006 will be another year of investment, and much like 2005, we expect to see all of our EPS growth in the fourth quarter. The difference is that we are making investments in 2006 with clearer visibility as to where capital is best deployed to drive the greatest return, and we have new programs in place, such as Borders Rewards, which we anticipate will drive increased traffic and higher transaction values in 2006.

Looking further ahead to 2007, as the benefits of our investments are more fully realized, we expect consolidated earnings per share growth to be more in line with our long-term goal for annual EPS growth in the mid teens. I remain confident that we have the right strategy, people, and opportunities in place to meet this goal and achieve long-term growth for our shareholders.

Sincerely,

Gregory P. Josefowicz
Chairman, President and Chief Executive Officer

A Message from the Board of Directors

On January 23, 2006, the company announced that Greg Josefowicz will retire from his position as Chairman, President, and CEO of Borders Group within two years. To ensure a smooth and orderly transition, we have formed a committee of independent directors to select Greg's successor, and we are currently conducting an extensive internal and external search. The Board and I would like to thank Greg for his extraordinary contributions to our company over the past six years. We remain committed to the current business strategy and goals, and we are confident that Greg and his team will continue to manage the company well during this period of transition.

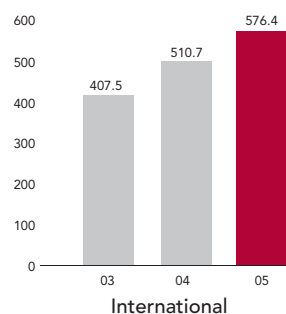
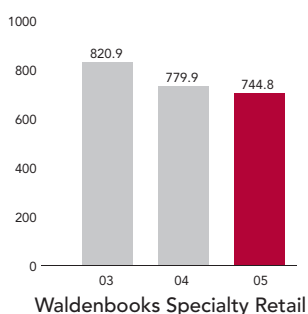
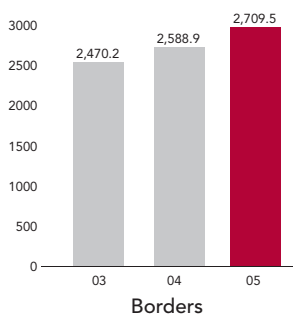
Amy B. Lane
Presiding Director

2005 financial highlights

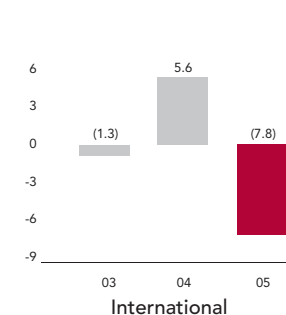
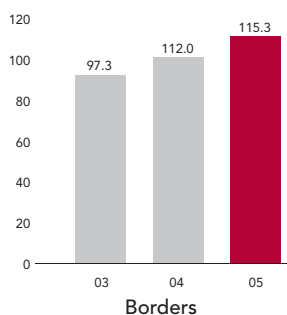


| | fiscal year ended | | |
|---|-------------------|--------------|--------------|
| | Jan 28, 2006* | Jan 23, 2005 | Jan 25, 2004 |
| (dollars in millions except per share data) | | | |
| sales | \$4,030.7 | \$3,879.5 | \$3,698.6 |
| % increase | 3.9% | 4.9% | 6.1% |
| consolidated net income | \$101.0 | \$131.9 | \$115.2 |
| consolidated diluted EPS | \$1.42 | \$1.69 | \$1.46 |
| consolidated cash, net of debt | \$(130.9) | \$143.2 | \$180.4 |
| return on beginning equity | 9.3% | 12.0% | 11.7% |

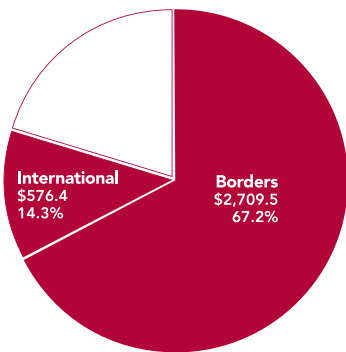
SEGMENT SALES (dollars in millions)



SEGMENT NET INCOME (dollars in millions)



CONSOLIDATED SALES (dollars in millions)



*53-week year



Board of Directors

Donald G. Campbell, Senior Executive Vice President, Chief Administrative & Business Development Officer, The TJX Companies, Inc.

Joel J. Cohen, Chairman & Co-Chief Executive Officer, Sagent Advisors, Inc.

Gregory P. Josefowicz, Chairman, President & Chief Executive Officer, Borders Group, Inc.

Amy B. Lane, Retired Managing Director, Investment Banking Group, Merrill Lynch

Brian T. Light, Executive Vice President & Chief Information Officer, Staples, Inc.

Victor L. Lund, Retired Chairman of the Board, American Stores Company

Dr. Edna Greene Medford, Associate Professor of History & Director of the Graduate Program in History at Howard University

Lawrence I. Pollock, President, Lucky Stars Investments Limited Company

Beth M. Pritchard, Former President & Chief Executive Officer of Bath & Body Works, a division of Limited Brands, Inc.

Michael Weiss, Retired President & Chief Executive Officer of Express, a subsidiary of Limited Brands, Inc.

Executive Officers

Vincent E. Altruda, President, Borders Group U.S.

Thomas D. Carney, Senior Vice President, General Counsel & Secretary

Gregory P. Josefowicz, Chairman, President & Chief Executive Officer

Daniel T. Smith, Senior Vice President, Human Resources

Cedric J. Vanzura, President, Borders Group International, Paperchase Worldwide & Information Technology

Edward W. Wilhelm, Senior Vice President, Chief Financial Officer

proxy
statement

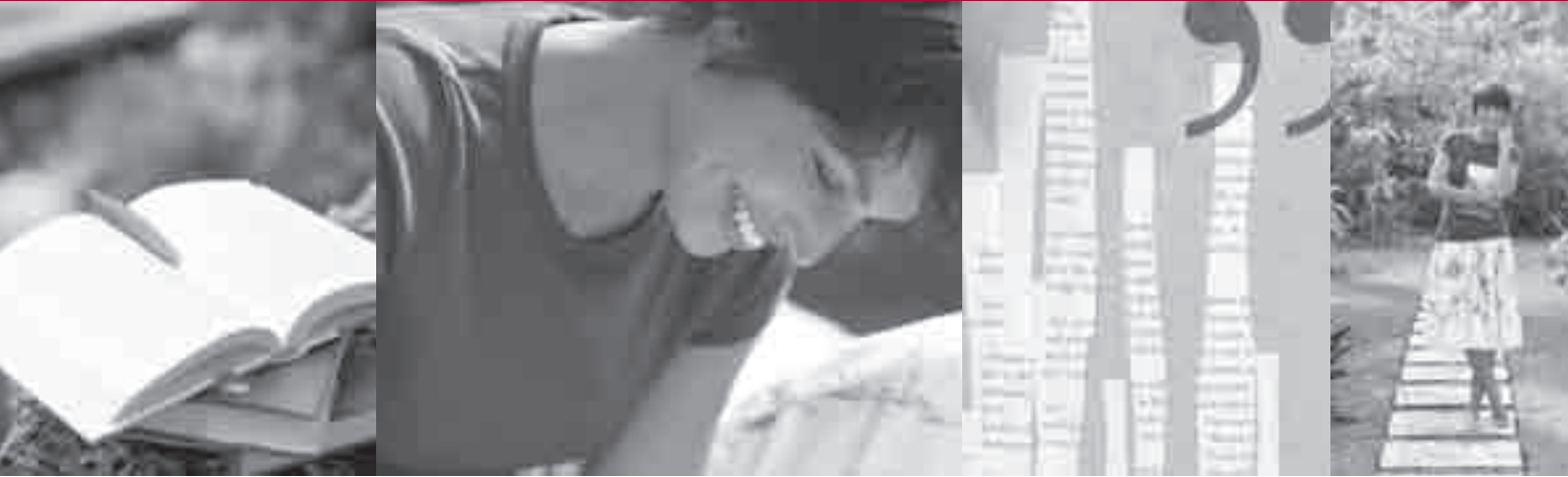


proxy statement
relating to annual stockholders' meeting
May 25, 2006

BORDERS

Group

form
10-K



form 10-K
for fiscal year
ended January 28, 2006

BORDERS
Group

