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

Overview

Best Buy Co., Inc. is a specialty retailer with fiscal 2003 revenue from continuing operations of $20.9 billion. We operate two reportable segments: Domestic and International. The Domestic segment includes U.S. Best Buy and Magnolia Hi-Fi, Inc. (Magnolia Hi-Fi) stores. U.S. Best Buy stores offer a wide variety of consumer electronics, home-office equipment, entertainment software and appliances, operating 548 stores in 48 states at the end of fiscal 2003. Magnolia Hi-Fi is a high-end retailer of audio and video products with 19 stores in Washington, Oregon and California. Magnolia Hi-Fi was acquired in the fourth quarter of fiscal 2001.

The International segment was established in connection with our acquisition of Future Shop Ltd. (Future Shop) in November of fiscal 2002. At the end of fiscal 2003, the International segment consisted of 104 Future Shop stores operating in all Canadian provinces and eight Canadian Best Buy stores operating in Ontario. Future Shop and Canadian Best Buy stores offer products similar to that of U.S. Best Buy stores.

During the fourth quarter of fiscal 2001, we acquired Musicland Stores Corporation (Musicland). Musicland is primarily a mall-based national retailer of prerecorded music, movies and other entertainment-related products. Musicland operated 1,195 stores in 48 states, the U.S. Virgin Islands and Puerto Rico at the end of fiscal 2003. During the fourth quarter of fiscal 2003, we committed to a plan to sell our interest in Musicland. In accordance with Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets,* Musicland's financial results have been classified as discontinued operations in our consolidated financial statements for all periods presented. For additional information regarding our discontinued operations, refer to note 2 of the Notes to Consolidated Financial Statements on page 52.

All three acquisitions described above were accounted for using the purchase method. Under this method, net assets and results of operations of those businesses were included in our consolidated financial statements from their respective dates of acquisition.

Fiscal 2003 and 2002 each included 52 weeks, while fiscal 2001 included 53 weeks.

Unless otherwise noted, the following discussion relates only to results from continuing operations, and comparisons are with fiscal 2002 results as-adjusted. As-adjusted information presents the results of operations as though Future Shop had been acquired at the beginning of fiscal 2002. In addition, the as-adjusted results conform the accounting for vendor allowances to the new method adopted in fiscal 2003. All periods presented also reflect the classification of Musicland's financial results as discontinued operations.

Strategic Vision

Our vision is to make life fun and easy. Our business strategy is to bring technology and consumers together in a retail environment that focuses on educating consumers on the features and benefits of technology and entertainment, while maximizing overall profitability. We believe our stores offer consumers meaningful advantages in terms of environment, product value, selection and service, all of which advance our objective of gaining market share. The Future Shop and Magnolia Hi-Fi acquisitions provide us with access to new distribution channels and new customers.

During fiscal 2003, we formalized four strategic priorities that we believe will further enhance our business model over the next several years. The four strategic priorities are:

- Customer Centricity
- Efficient Enterprise
- Win the Home with Service
- Win Entertainment

Customer Centricity

Our customers are at the core of all of our business strategies. In short, customer centricity means putting the customer at the center of everything we do. The customer centricity strategy includes tailoring our store experience to the specific product needs of our customers. We want to leverage our customer knowledge and tailor product and service offerings to meet our customers' specific product and service needs. Our goal is to provide the "complete solution" to our customers and to provide them with products that can be integrated with their lifestyle.

Efficient Enterprise

Our business has grown substantially over the past five years, with revenue from continuing operations increasing from $8.3 billion to $20.9 billion. We have made significant investments in our infrastructure, including people and technology, to support business growth. As we move forward, we are developing an operating model that is agile and flexible and is anticipated to deliver sustained productivity gains. This model includes leveraging our existing investments and continually managing our expense structure to ensure it meets the current and future needs of our business.

Win the Home with Service

This strategy focuses on creating a market-leadership position in delivering lifestyle-based solutions for our customers, including selection, installation and integration of multiple technologies. Our customers' consumer electronics needs are becoming more complex with the continued development of new products and the need to access multiple networked technologies within the home. We are committed to selling, installing and supporting technologies that create an integrated digital home. We believe this approach will differentiate us from many of our competitors who sell technology products but do not provide installation and support services. Our goal is to create a life-long relationship with our customers that focuses on product selection, home integration, service and future technology upgrades.

Win Entertainment

Another strategic priority is to gain market share in the rapidly changing entertainment category. This category includes music, movies, video game hardware and software, subscriptions and other related products. The development and delivery of entertainment products have undergone significant changes in recent years. New video game platforms have generated strong revenue. Conversely, industry-wide prerecorded music sales have experienced double-digit declines in each of the past two years as consumers continue to download music directly from the Internet. The Win Entertainment strategy includes supporting the development and delivery of new entertainment-related products through multiple distribution channels and increasing our market share. We want to be the consumers' preferred choice when purchasing entertainment products.

Planned Sale of Musicland Business

We have committed to a plan to sell our interest in Musicland. We determined that the interests of our shareholders, employees, vendors and landlords would be best served by a sale of the business. Accordingly, we have retained a national investment banking firm to identify potential buyers and to market actively our interest in Musicland. We also have retained additional professionals to assist in other areas of the plan. The sale of our interest in Musicland will allow us to focus on our consumer electronics stores, which are the core growth and profit drivers for our business.

The original strategy behind the Musicland acquisition was to bring Best Buy's core competencies in retailing consumer electronics to new consumer segments, including segments typically underserved by our Best Buy stores. Musicland's mall-based stores and rural market locations gave us access to more young people and more rural communities. In addition, we believed integrating certain administrative and support functions within our existing infrastructure could increase the overall profitability of the Musicland business. However, for a number of reasons, the Musicland business did not meet our financial objectives. First, Musicland was not as successful as we hoped in selling digital products, even at Best Buy prices, because many consumers assumed that products sold in a mall-based environment were not price-competitive. Second, we did not anticipate such steep and protracted declines in sales of prerecorded music or significant declines in mall traffic. Third, Musicland reduced the assortment of CDs at its stores, a move that had increased inventory turns and profits at our Best Buy stores, but the reduced music assortment led to the loss of some core customers. Fourth, Musicland was successful in introducing DVD movies and video gaming at Sam Goody stores; however, these products carry a lower gross profit rate than CDs and did not provide incremental profits sufficient to make the Musicland business viable.

Significant Accounting Matters

During fiscal 2003, certain accounting matters significantly impacted our reported financial results and related presentation.

In fiscal 2003, we recorded the significant non-cash charges summarized in the table below ($ in millions):

Significant Fiscal 2003 Non-Cash Charges, Net of Tax	Continuing Operations	Discontinued Operations	Total
Cumulative effect of change in accounting principle for goodwill	$40	$308	$348
Long-lived asset impairment charge	—	102	102
Cumulative effect of change in accounting principle for vendor allowances	42	8	50
Significant fiscal 2003 non-cash charges, net of tax	$82	$418	$500

The $348 million goodwill impairment charge relates to our adoption of SFAS No. 142, *Goodwill and Other Intangible Assets,* at the beginning of fiscal 2003. In accordance with SFAS No. 142, we completed the required goodwill impairment testing in the second quarter of fiscal 2003. As a result of the testing, we determined that the asset carrying value of our Musicland and Magnolia Hi-Fi businesses exceeded their current fair values. The resulting after-tax, non-cash impairment charge was $348 million ($1.07 per diluted share), of which $308 million was associated with Musicland and $40 million was associated with Magnolia Hi-Fi. The charge represented a complete write-off of the goodwill associated with these businesses. For additional information regarding the change in accounting for goodwill, refer to Change in Accounting Principles – Goodwill and Vendor Allowances in note 1 in the Notes to Consolidated Financial Statements on page 51.

During the fourth quarter of fiscal 2003, we incurred a $102 million after-tax, non-cash impairment charge ($166 million before tax), related to a reassessment of the carrying value of Musicland's long-lived assets, in accordance with SFAS No. 144. We included this non-cash charge in discontinued operations.

During fiscal 2003, we changed our method of accounting for vendor allowances in accordance with Emerging Issues Task Force (EITF) Issue No. 02-16, *Accounting by a Reseller for Cash Consideration Received from a Vendor.* The adoption of EITF No. 02-16 was accounted for as a cumulative effect of a change in accounting principle effective on March 3, 2002, the beginning of fiscal 2003. The cumulative effect of the change in accounting for vendor allowances resulted in an after-tax, non-cash, charge to net earnings of $50 million, of which $8 million was associated with Musicland and included in discontinued operations.

The change in accounting for vendor allowances also impacted the timing of vendor allowances recognized during interim periods of fiscal 2003 and the classification of vendor allowances in our statement of earnings. Based on EITF No. 02-16, vendor allowances generally are recognized in earnings when the product is sold or the service is performed. Prior to the adoption of EITF No. 02-16, we generally recognized vendor allowances based on the provisions of the specific vendor agreement. The change in accounting method reduced fiscal 2003 earnings from continuing operations by $1 million, due to the timing of recognizing vendor allowances. Also, as a result of recognizing the majority of vendor allowances in cost of goods sold rather than in selling, general and administrative expenses (SG&A), our fiscal 2003 gross profit rate increased by 3.4% of revenue and our fiscal 2003 SG&A rate increased by 3.4% of revenue. For additional information regarding the change in accounting for vendor allowances, refer to "Change in Accounting Principles – Goodwill and Vendor Allowances" in note 1 of the Notes to Consolidated Financial Statements on page 51.

For information regarding the impact of EITF No. 02-16 on our fiscal 2003 annual and quarterly results and fiscal 2002 annual and fourth quarter results, refer to our Current Reports on Form 8-K filed with the Securities and Exchange Commission on April 3, 2003, and April 7, 2003.

Results of Operations

Fiscal 2003 Summary

- Earnings from continuing operations increased 10% in fiscal 2003 to $622 million, compared with $564 million in the prior fiscal year. The increase was driven by a 13% increase in revenue and a modest improvement in our gross profit rate, partially offset by a higher SG&A rate.
- Revenue increased 13% in fiscal 2003 to $20.9 billion, compared with $18.5 billion in the prior fiscal year. The increase was primarily due to the opening of 67 new U.S. Best Buy stores and 17 new stores in our International segment, as well as a 2.4% comparable store sales increase.
- Our gross profit rate increased slightly in fiscal 2003 to 25.0% of revenue, compared with 24.9% of revenue in the prior fiscal year, primarily due to a higher-margin revenue mix, partially offset by a more promotional environment.
- The SG&A rate increased to 20.2% of revenue in fiscal 2003, compared with 20.0% of revenue in the prior fiscal year. The increase was primarily due to increased expenses in our International segment related to the launch of Canadian Best Buy stores and to improving the future efficiency and profitability of our International segment. The SG&A rate in the Domestic segment was relatively flat as compared with the prior fiscal year.
- Our fiscal 2003 results also were impacted by significant non-cash charges discussed in the Significant Accounting Matters section on page 22. Significant non-cash charges totaled $500 million after-tax, including $418 million related to discontinued operations.
- In fiscal 2003, the loss from discontinued operations totaled $441 million, net of tax, and included significant non-cash charges of $418 million, net of tax. Discontinued operations also included a $72 million operating loss, before asset impairment charge, primarily attributable to revenue declines at Musicland's mall-based stores.

Consolidated Results

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

	2003	As-Adjusted 2002[1]	2002	2001
Revenue	$20,946	$18,506	$17,711	$15,189
Revenue % change	13%	N/A	17%	22%
Comparable stores sales % change[2]	2.4%	N/A	1.9%	4.9%
Gross profit as a % of revenue	25.0%	24.9%	21.3%	19.8%
SG&A as a % of revenue	20.2%	20.0%	16.2%	15.8%
Operating income	$ 1,010	$ 903	$ 908	$ 611
Operating income as a % of revenue	4.8%	4.9%	5.1%	4.0%
Earnings from continuing operations	$ 622	$ 564	$ 570	$ 401
Loss from discontinued operations, net of tax	(441)	—	—	(5)
Cumulative effect of change in accounting principles, net of tax	(82)	—	—	—
Net earnings	99	564	570	396
Diluted earnings per share – continuing operations	$ 1.91	$ 1.75	$ 1.77	$ 1.26
Diluted earnings per share	$ 0.30	$ 1.75	$ 1.77	$ 1.24

Note: All periods presented reflect the classification of Musicland's financial results as discontinued operations.

(1) As-adjusted information conforms the accounting for vendor allowances to the fiscal 2003 method and is reflected as if Future Shop had been acquired at the beginning of fiscal 2002. As-adjusted data is unaudited.

(2) Includes revenue at stores and Internet sites operating for at least 14 full months, as well as remodeled and expanded locations. Relocated stores are excluded from the comparable store sales calculation until at least 14 full months after reopening. Acquired stores are included in the comparable store sales calculation beginning with the first full quarter following the first anniversary of the date of acquisition. The calculation of the comparable store sales change excludes Musicland revenue, which is included in discontinued operations.

Continuing Operations

Fiscal 2003 Results Compared with Fiscal 2002

Net earnings from continuing operations for fiscal 2003 increased 10% to $622 million, compared with $564 million in fiscal 2002 on an as-adjusted basis and $401 million in fiscal 2001. Earnings per diluted share from continuing operations increased to $1.91 in fiscal 2003, compared with $1.75 as adjusted in fiscal 2002 and $1.26 in fiscal 2001.

The increase in earnings from continuing operations was primarily driven by a 13% revenue increase and a slight improvement in the gross profit rate, partially offset by a higher SG&A rate. The revenue increase resulted from the opening of 67 U.S. Best Buy, eight Canadian Best Buy and nine Future Shop stores in the past 12 months, a full year of revenue from new stores opened in fiscal 2002, as well as a 2.4% comparable store sales gain. Approximately four-fifths of the increase in revenue was due to the opening of new stores in the past two fiscal years. The remainder of the increase was due to the comparable store sales gain.

Our gross profit rate in fiscal 2003 increased slightly to 25.0% of revenue, versus 24.9% of revenue in the prior fiscal year. The improvement in the gross profit rate was primarily due to a more profitable revenue mix at U.S. Best Buy stores, including increased revenue from higher-margin digital products. A more promotional environment limited improvement in the gross profit rate.

Our SG&A rate was 20.2% of revenue in fiscal 2003, an increase of 0.2% of revenue over the prior fiscal year's rate. The increase in the SG&A rate was primarily due to increased expenses in our International segment to support strategic initiatives, including the launch of Best Buy stores in Canada and investments intended to improve the future efficiency and profitability of our International segment. The SG&A rate also increased due to the deleveraging effect of a modest comparable store sales increase, as operating expenses increased at a faster rate than comparable store sales. In addition, the SG&A rate was negatively impacted by higher consulting expenses, increased depreciation expenses related to technology investments, and lease termination and asset impairment charges associated with vacating existing corporate facilities in connection with the relocation to our new corporate campus in fiscal 2004. Increases in the SG&A rate were partially offset by expense-saving initiatives implemented in the second half of fiscal 2003, reduced performance-based compensation and expense leverage from opening new stores in existing markets.

Fiscal 2002 Results Compared with Fiscal 2001

The discussion and analysis of fiscal 2002 results compared with fiscal 2001 reflects the classification of Musicland's results as discontinued operations, but does not reflect the new accounting method for vendor allowances adopted in fiscal 2003.

Fiscal 2002 revenue increased 17% to $17.7 billion, compared with $15.2 billion in fiscal 2001. Approximately two-thirds of the revenue increase, compared with the prior fiscal year, was due to the addition of 62 U.S. Best Buy stores during fiscal 2002 and a full year of revenue from stores opened in fiscal 2001. Approximately one-tenth of the revenue increase was attributable to a 1.9% comparable store sales increase at U.S. Best Buy stores. The remainder of the revenue increase was principally due to the inclusion of revenue from the International segment due to the acquisition of Future Shop in the third quarter of fiscal 2002. The 1.9% comparable store sales increase in fiscal 2002 was offset by the inclusion of an extra week of operations in fiscal 2001, which increased fiscal 2001 revenue by approximately $280 million.

The gross profit rate in fiscal 2002 increased to 21.3% of revenue, compared with 19.8% of revenue in fiscal 2001. 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.

The fiscal 2002 SG&A rate increased to 16.2% of revenue compared with 15.8% of revenue in fiscal 2001. This increase was primarily due to 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 the absence of certain non-recurring expenses incurred in fiscal 2001 for the relaunch of BestBuy.com™, our entry into the New York market and the write-off of certain e-commerce investments.

Segment Performance

Domestic

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

Segment Performance Summary (unaudited)	2003	As-Adjusted 2002[1]	2002	2001[2]
Revenue	$19,303	$17,115	$17,115	$15,189
Comparable stores sales % change[3]	2.4%	1.9%	1.9%	4.9%
Gross profit as a % of revenue	25.0%	24.9%	21.2%	19.8%
SG&A as a % of revenue	19.8%	19.8%	16.0%	15.8%
Operating income	$ 1,002	$ 876	$ 886	$ 611
Operating income as a % of revenue	5.2%	5.1%	5.2%	4.0%

Note: All periods presented reflect the classification of Musicland's financial results as discontinued operations.

(1) As-adjusted information conforms the accounting for vendor allowances to the fiscal 2003 method.

(2) Includes results of operations of Magnolia Hi-Fi since its acquisition in the fourth quarter of fiscal 2001.

(3) Includes revenue at stores and Internet sites operating for at least 14 full months, as well as remodeled and expanded locations. Relocated stores are excluded from the comparable store sales calculation until at least 14 full months after reopening. Acquired stores are included in the comparable store sales calculation beginning with the first full quarter following the first anniversary of the date of acquisition. The calculation of the comparable store sales change excludes Musicland revenue, which is included in discontinued operations.

Domestic operating income increased 14% to $1.0 billion in fiscal 2003, compared with $876 million in fiscal 2002 on an as-adjusted basis. The increase in operating income was primarily due to the addition of 67 new U.S. Best Buy stores in the past 12 months, a full year of revenue from new stores opened in fiscal 2002 and a slight improvement in the gross profit rate.

Domestic revenue increased to $19.3 billion in fiscal 2003, a 13% increase over fiscal 2002 revenue of $17.1 billion. Approximately four-fifths of the revenue increase was due to new U.S. Best Buy stores opened in the past two fiscal years. The remainder of the revenue increase was attributable to the 2.4% comparable store sales gain for the fiscal year. The comparable store sales gain was primarily the result of revenue gains in the entertainment software and consumer electronics product categories, partially offset by revenue declines in the home office and appliances categories. Comparable store sales gains in the entertainment software category were driven by double-digit comparable store sales increases in video gaming hardware and software and DVD movies. The growth in the entertainment software category was partially offset by weak sales of prerecorded music resulting from the continuing trend of downloading music via Internet sites and increasing consumer awareness of CD recording technology. The consumer electronics category experienced a mid-single-digit comparable store sales increase, fueled by increased digital product revenue. Digital product revenue comprised 22% of the revenue mix in fiscal 2003, compared with 17% the prior fiscal year. Within the consumer electronics category, digital televisions and digital cameras were the primary products driving the comparable store sales gain. Declines in revenue from analog televisions and VCR players, products being replaced by new technology, partially offset gains generated in other consumer electronics product groups. Comparable store sales in the home office category declined slightly, primarily due to continued weakness in sales of desktop computers and reduced prices for computer peripherals. The decline was partially offset by increased revenue from notebook computers and MP3 players. Appliance revenue experienced a high-single-digit comparable store sales decline due to reduced consumer demand and increased competition.

The Domestic gross profit rate increased to 25.0% of revenue in fiscal 2003, compared with 24.9% of revenue the prior fiscal year. The gross profit rate improvement was mainly due to a more profitable revenue mix at U.S. Best Buy stores. Revenue in the higher-margin consumer electronics category experienced larger increases than revenue in the home office category, which generally includes lower-margin products. In addition, the gross profit rate benefited modestly from improved supply chain management. The gross profit rate was negatively impacted by gross profit rate declines in the home office product category, partially due to promotional pressure on desktop computers, the largest product group in the category.

The fiscal 2003 SG&A rate for the Domestic segment was 19.8% of revenue, consistent with the prior fiscal year. The SG&A rate was negatively impacted by the deleveraging effect of a modest comparable store sales increase; increased depreciation expense related to technology investments; and investments in personnel and outside consultants to support strategic initiatives and business growth. In addition, the SG&A rate was impacted by lease termination and asset impairment charges associated with vacating existing corporate facilities in connection with the relocation to our new corporate campus in fiscal 2004. These factors were offset by expense reductions initiated in the second half of fiscal 2003 and additional expense leverage resulting from opening new stores in existing markets.

The following table reconciles Domestic stores open at the beginning and end of fiscal 2003:

	Total Stores at End of Fiscal 2002	Stores Opened	Stores Closed	Total Stores at End of Fiscal 2003
U.S. Best Buy stores	481	67	—	548
Magnolia Hi-Fi stores	13	6	—	19
Total	494	73	—	567

The following table reconciles Domestic stores open at the beginning and end of fiscal 2002:

	Total Stores at End of Fiscal 2001	Stores Opened	Stores Closed	Total Stores at End of Fiscal 2002
U.S. Best Buy stores	419	62	—	481
Magnolia Hi-Fi stores	13	—	—	13
Total	432	62	—	494

During fiscal 2003, we opened 67 new U.S. Best Buy stores, including 33 stores in our 45,000-square-foot format and 34 stores in our smaller-market formats. At the end of fiscal 2003, we operated 548 U.S. Best Buy stores compared with 481 stores at the end of fiscal 2002. In addition, we remodeled three U.S. Best Buy stores and expanded one U.S. Best Buy store during fiscal 2003, compared with three remodeled stores and two expanded stores in fiscal 2002. Magnolia Hi-Fi opened six new stores during fiscal 2003 and operated 19 stores at the end of the fiscal year. Magnolia Hi-Fi did not remodel or expand any stores during fiscal 2003 or 2002.

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)	2003	As-Adjusted 2002[1]	2002[2]
Revenue	$1,643	$1,391	$596
Comparable stores sales % gain[3]	4.3%	N/A	17.4%
Gross profit as a % of revenue	25.0%	25.0%	23.4%
SG&A as a % of revenue	24.5%	23.1%	19.7%
Operating income	$ 8	$ 27	$ 22
Operating income as a % of revenue	0.5%	1.9%	3.7%

(1) As-adjusted information presents the results of operations as though Future Shop had been acquired at the beginning of fiscal 2002 and conforms the accounting for vendor allowances to the fiscal 2003 method.

(2) Reflects results of operations of Future Shop subsequent to its acquisition in November of fiscal 2002.

(3) Includes revenue at stores and Internet sites operating for at least 14 full months, as well as remodeled and expanded locations. Relocated stores are excluded from the comparable store sales calculation until at least 14 full months after reopening. Acquired stores are included in the comparable store sales calculation beginning with the first full quarter following the first anniversary of the date of acquisition. The calculation of the comparable store sales gain excludes the impact of fluctuations in the foreign currency exchange rates.

The International segment generated operating income of $8 million in fiscal 2003, compared with $27 million on an as-adjusted basis in the prior fiscal year. The decline in operating income was primarily due to higher SG&A, partially offset by increased gross profits resulting from revenue growth.

International revenue increased 18% to $1.6 billion, compared with $1.4 billion last fiscal year. New store openings and a 4.3% comparable store sales gain drove the increase in revenue. Approximately four-fifths of the revenue gain was attributable to the opening of new stores in the past two fiscal years. The remainder of the revenue gain was due to the comparable store sales gain. The comparable store sales gain was driven by increased revenue from entertainment software and consumer electronics products, which includes rapidly expanding revenue from digital products.

The International gross profit rate was 25.0% of revenue in fiscal 2003, unchanged from the prior fiscal year. The gross profit rate benefited from a shift in the revenue mix to higher-margin digital products and accessories. The benefit from the higher-margin revenue mix was offset by rising costs for third-party credit in the latter part of the fiscal year and a more promotional environment.

The SG&A rate for the International segment increased to 24.5% of revenue, compared with 23.1% of revenue in the prior fiscal year. The SG&A rate increase was primarily due to expenses associated with launching Canadian Best Buy stores and strategic investments intended to improve the future efficiency and profitability of International operations. The SG&A rate increase was partially offset by expense leverage due to new store openings and the comparable store sales gain.

The following table reconciles International stores open at the beginning and end of fiscal 2003:

	Total Stores at End of Fiscal 2002	Stores Opened	Stores Closed	Total Stores at End of Fiscal 2003
Future Shop stores	95	9	—	104
Canadian Best Buy stores	—	8	—	8
Total	95	17	—	112

The following table reconciles International stores open at the beginning and end of fiscal 2002:

	Total Stores at End of Fiscal 2001	Stores Acquired Fiscal 2002	Stores Opened	Stores Closed	Total Stores at End of Fiscal 2002
Future Shop stores	—	91	4	—	95
Canadian Best Buy stores	—	—	—	—	—
Total	—	91	4	—	95

During fiscal 2003, we finalized the allocation of the Future Shop purchase price to the assets and liabilities acquired. The primary adjustments to the preliminary purchase price allocation were to assign value to the "Future Shop" trade name as a result of our decision to operate stores in Canada under both the Best Buy and Future Shop trade names and to adjust the extended service contract liability assumed as of the date of acquisition based on additional information. The final purchase price allocation resulted in a $5 million decrease to goodwill from our preliminary allocation. For more information regarding the final purchase price allocation, refer to note 3 of the Notes to Consolidated Financial Statements on page 54.

During the fourth quarter of fiscal 2003, we completed our annual impairment testing of the goodwill recorded in our International segment and determined that no impairment existed based on expectations for the business and the prevailing retail environment.

Discontinued Operations

During the fourth quarter of fiscal 2003, we committed to a plan to sell our interest in Musicland. In accordance with SFAS No. 144, we have reported the results of operations and financial position of Musicland in discontinued operations. Fiscal 2003, 2002 as adjusted, 2002 and 2001, reflect the classification of Musicland's financial results as discontinued operations.

The results from discontinued operations for the past three fiscal years are as follows ($ in millions):

Discontinued Operations Performance Summary (unaudited)	2003	As-Adjusted 2002[1]	2002	2001[2]
Revenue	$1,727	$1,886	$1,886	$ 138
Operating (loss) income before impairment	(72)	31	29	(7)
Long-lived asset impairment charge	(166)	—	—	—
Operating (loss) income	(238)	31	29	(7)
Interest expense	(6)	(20)	(19)	(1)
(Loss) earnings before income tax expense	(244)	11	10	(8)
Income tax (benefit) expense[3]	(119)	11	10	(3)
Loss before cumulative effect of accounting changes, net of tax	(125)	—	—	(5)
Cumulative effect of changes in accounting principles, net of tax	(316)	—	—	—
Loss from discontinued operations, net of tax	$ (441)	$ —	$ —	$ (5)

(1) As-adjusted information conforms the accounting for vendor allowances to the fiscal 2003 method.

(2) Reflects results of operations of Musicland subsequent to its acquisition in the fourth quarter of fiscal 2001.

(3) Fiscal 2003 includes a $25 million tax benefit resulting from the differences between the basis of assets and liabilities for financial reporting and income taxes arising at acquisition which will be realized upon the disposition of Musicland.

Musicland incurred an operating loss of $72 million before impairment in fiscal 2003 compared with $31 million of operating income on an as-adjusted basis in the prior fiscal year. The decline in operating income was primarily due to reduced revenue and a lower gross profit rate. The reduced revenue resulted from the continued decline in revenue from prerecorded music, a reduction in the number of customers visiting shopping malls and increased competition from discount stores and big-box retailers. The gross profit rate declined in fiscal 2003 as a result of a change in the revenue mix at Musicland stores, due to increased revenue from lower-margin DVD movies and video gaming hardware and software and decreased revenue from higher-margin prerecorded music. In addition, a more promotional environment negatively impacted Musicland's gross profit rate. The loss from discontinued operations, net of tax, was $441 million in fiscal 2003, compared with break-even results in fiscal 2002 as adjusted and a $5 million loss in fiscal 2001, which included results of operations only subsequent to the date of acquisition.

In fiscal 2003, the $441 million loss from discontinued operations, net of tax, includes significant non-cash charges totaling $418 million. The charges include a $308 million after-tax goodwill impairment charge, an $8 million after-tax charge related to the change in accounting for vendor allowances and a $102 million after-tax charge ($166 million before tax) related to impairment of long-lived assets. In addition, discontinued operations includes a $23 million net loss from operations comprised of a $72 million operating loss before asset impairment charge, $6 million of interest expense and $55 million of income tax benefit. The $55 million income tax benefit includes $25 million resulting from differences between the basis of assets and liabilities for financial reporting and income taxes arising at acquisition which will be realized upon disposition of Musicland. Refer to the Significant Accounting Matters section on page 22 for additional details.

The fiscal 2003 loss from discontinued operations excludes future operating results and any future gains or losses resulting from the potential sale of our interest in Musicland. The final financial impact of the planned sale of our interest in Musicland is dependent upon the results of negotiations with the ultimate buyer(s).

Additional Consolidated Results

Net Interest Income

Net interest income from continuing operations decreased to $4 million in fiscal 2003, compared with $18 million in fiscal 2002. The decrease in net interest income was primarily due to lower yields on short-term investments and a full year of interest expense associated with convertible debentures issued during fiscal 2002.

Net interest income from continuing operations declined to $18 million in fiscal 2002, compared with $38 million in fiscal 2001. The decrease in net interest income was primarily due to lower yields on short-term investments, as average interest rates declined by more than 200 basis points in fiscal 2002 compared with fiscal 2001. The impact of lower yields was partially offset by higher average cash balances resulting from strong operating cash flows and net proceeds from the issuance of convertible debentures.

Effective Income Tax Rate

Our effective income tax rate from continuing operations increased to 38.7% in fiscal 2003, as compared with 38.4% in the prior year on an as-adjusted basis. The increase in the effective income tax rate in fiscal 2003 was primarily due to increased tax expense related to our International segment and a slight increase in the effective state income tax rate.

Our effective income tax rate in fiscal 2002 was 38.4%, up slightly from 38.3% in fiscal 2001. Historically, our effective income tax rate has been impacted primarily by the taxability of investment income and state income taxes.

Liquidity and Capital Resources

Summary

Despite a challenging economic environment in fiscal 2003, our financial condition at the end of the year was strong and positioned us well for fiscal 2004. Cash and cash equivalents totaled $1.9 billion at the end of fiscal 2003, a slight increase from the end of fiscal 2002. Working capital, the excess of current assets over current liabilities, increased to $1.1 billion at the end of fiscal 2003, compared with $895 million at the end of fiscal 2002. In addition, our long-term debt-to-capitalization ratio declined slightly to 23% at the end of fiscal 2003, as compared with 24% at the end of fiscal 2002.

A component of our long-term strategy is our capital expenditure program. This program includes, among other things, investments in new stores, store remodeling, store relocations and expansions, new distribution facilities and information technology enhancements. During fiscal 2003, we invested $725 million in property and equipment in continuing operations, including opening 90 new stores; remodeling, relocating and/or expanding 17 stores; continued construction of our new corporate campus; and improvements to our distribution centers and information systems.

Cash Flows

Cash provided by operating activities from continuing operations was $746 million in fiscal 2003, compared with $1.5 billion in fiscal 2002 and $861 million in fiscal 2001. The decrease in operating cash flows in fiscal 2003, compared with the prior fiscal year, was primarily due to the decrease in cash provided from changes in operating assets and liabilities, partially offset by increased earnings from continuing operations. Earnings from continuing operations increased to $622 million in fiscal 2003 as compared with $570 million in the prior fiscal year. Receivables increased due to the addition of new stores, timing of payments and increased cooperative advertising receivables. Merchandise inventories increased in fiscal 2003, primarily due to the addition of new stores and improved in-stock positions. Accounts payable decreased slightly, primarily due to the timing of vendor payments and increased business volume. These decreases in cash were partially offset by cash provided by higher accrued income taxes resulting from the increase in earnings from continuing operations and an increase in other liabilities due to business growth and increased gift card liabilities.

Cash used in investing activities from continuing operations was $659 million in fiscal 2003, compared with $924 million and $1.0 billion in fiscal 2002 and 2001, respectively. In fiscal 2003, we used cash for construction of new retail locations, information systems, distribution center improvements, and other additions to property, plant and equipment, including continued construction of our new corporate campus. The primary purposes of the cash investment activity were to support our expansion plans, to improve our operational efficiency and to enhance shareholder value. In fiscal 2002, we used cash for investments in property, plant and equipment and the acquisition of Future Shop.

Cash provided by financing activities from continuing operations was $45 million in fiscal 2003, compared with $769 million in fiscal 2002 and $218 million in fiscal 2001. The change was primarily due to the issuance of convertible debentures in fiscal 2002. We raised $726 million, net of offering expenses, through the issuance of convertible debentures in fiscal 2002. Fiscal 2001 included a $200 million investment in our common stock by Microsoft Corporation. For more information regarding the convertible debentures, refer to note 4 of the Notes to Consolidated Financial Statements on page 55.

Cash used in discontinued operations was $79 million in fiscal 2003, compared with $270 million and $58 million in fiscal 2002 and 2001, respectively. The change in cash used in fiscal 2003, as compared to fiscal 2002, primarily related to the repayment of $274 million of long-term debt in fiscal 2002.

Sources of Liquidity

Funds generated by continuing operations and existing cash and cash equivalents continue to be our most significant sources of liquidity. Based on current levels of operations, we believe funds generated from the expected results of continuing 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 facilities are available for additional working capital needs or investment opportunities. There can be no assurance, however, that we will continue to generate cash flow at or above current levels or that we will be able to maintain our ability to borrow under the revolving credit facilities.

We have a $200 million unsecured revolving credit facility scheduled to mature in March 2005, of which $197 million was available at March 1, 2003. Outstanding letters of credit reduce amounts available under this facility. We also have a $200 million inventory financing line. At March 1, 2003, approximately $174 million was available under the inventory credit facility. 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 in fiscal 2003, 2002 or 2001. In addition, we have a $37 million unsecured credit facility related to International operations scheduled to mature in September 2003. At March 1, 2003, $15 million was available under this credit facility. Our current plans are to renew the $37 million unsecured credit facility during fiscal 2004.

We offer our customers extended financing through a third-party financial institution. The use of financing encourages consumers to purchase selected products and promotes our business. The third-party institution assumes the risk of collection from our customers and has no recourse against us for any uncollectible amounts. Generally, these financing offers allow customers to purchase products with repayment terms ranging from 90 days to 18 months without a finance charge. Our contract with the third-party financial institution extends through January 2009. If the contract were to be unexpectedly terminated or canceled, we would contract with an alternative third-party financial institution or directly provide our customers with extended financing.

Our credit ratings as of March 1, 2003, 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 ratings include changes in our operating performance, 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 ratings would be significantly downgraded. If a 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 occupancy costs. In addition, the conversion rights of the holders of our convertible debentures could be accelerated if our credit ratings were to be downgraded.

Off-Balance-Sheet Financing

Other than in connection with executing operating leases, we do not have any off-balance-sheet financing. We finance a portion of our new-store development program through sale-leaseback transactions, which involve selling stores to unrelated parties and then leasing the stores back under leases that are accounted for as operating leases in accordance with SFAS No. 13, *Accounting for Leases*. A summary of our operating lease obligations by fiscal year is included in the Contractual Obligations and Available Commercial Commitments section below.

We view our long-term debt-to-capitalization ratio as an important indicator or our creditworthiness. Our long-term debt-to-capitalization ratio, which represents the ratio of total long-term debt to total capitalization (total long-term debt plus total

Contractual Obligations and Available Commercial Commitments

The following tables present information regarding contractual obligations by fiscal year ($ in millions):

Continuing Operations

	Payments Due					
	2004	**2005**	**2006**	**2007**	**2008**	**Thereafter**
Operating leases	$413	$395	$363	$347	$340	$2,576
Long-term debt	1	1	61	1	1	764
Purchase commitments	20	—	—	—	—	—
Total	$434	$396	$424	$348	$341	$3,340

Discontinued Operations

	Payments Due					
	2004	**2005**	**2006**	**2007**	**2008**	**Thereafter**
Operating leases	$92	$89	$68	$54	$44	$147
Long-term debt	—	—	—	—	5	—
Purchase commitments	—	—	—	—	—	—
Total	$92	$89	$68	$54	$49	$147

Note: For more information regarding long-term debt, operating leases and purchase commitments, refer to notes 4, 7 and 11, respectively, in the Notes to Consolidated Financial Statements beginning on page 47.

The following table presents information regarding available commercial commitments and their expiration dates by fiscal year for continuing operations only; there are no available commercial commitments related to discontinued operations ($ in millions):

		Expires				
	Amount	**2004**	**2005**	**2006**	**2007**	**Thereafter**
Lines of credit[1]	$212	$ 15	$ —	$197	$ —	$ —
Inventory financing line[2]	174	174	—	—	—	—
Total	$386	$189	$ —	$197	$ —	$ —

(1) $3 of our $200 line of credit was committed to stand-by letters of credit, and $22 of our $37 line was utilized.

(2) $26 of the inventory financing line was utilized.

shareholders' equity), was 23% in fiscal 2003, compared with 24% in fiscal 2002. The ratio of total long-term debt to total capitalization including operating lease obligations (rental expenses for all operating leases multiplied by eight), was 67% in fiscal 2003, compared with 66% in fiscal 2002. Total long-term debt, including operating lease obligations, was $5.5 billion at March 1, 2003, and $5.0 billion at March 2, 2002. The long-term debt-to-capitalization ratio, including operating lease obligations, is not in accordance with, or preferable to, the ratio determined in accordance with accounting principles generally accepted in the United States.

Debt and Capital

In fiscal 2002, we sold convertible debentures due June 27, 2021, and January 15, 2022, with an initial principal amount at maturity of $492 million and $402 million, respectively. 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 indentures. 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. The shares related to the convertible debentures were not included in our diluted earnings-per-share computation in fiscal 2003 or 2002, as the criteria for conversion of the debentures were not met. For additional information regarding the convertible debentures, refer to note 4 of the Notes to Consolidated Financial Statements on page 55.

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 maintain certain financial ratios and a minimum net worth. As of the end of fiscal 2003, we were in compliance with all such covenants. In the event we were to default on any of our other debt, it would constitute a default under our credit facilities as well.

Our decision to own or lease real estate is based on an assessment of our financial liquidity, capital structure, our desire to own or to lease the location and the alternative that results in the highest returns to our shareholders. For those sites developed using working capital, we often sell and lease back those properties under long-term lease agreements. Through the end of fiscal 2003, $59 million in leases related to new stores had been financed under the master lease program. The master lease program is now complete and there will be no further new store development under this program. The program is set to expire on January 1, 2006, and is renewable for one year, subject to lenders' consent.

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 under the stock purchase program in fiscal 2003, 2002 or 2001.

Critical Accounting Policies

Our consolidated financial statements are prepared in accordance with generally accepted accounting principles. In connection with the preparation of the financial statements, we are required to make assumptions, make estimates and apply judgment that affect the reported amounts of assets, liabilities, revenue, expenses and the related disclosures. We base our assumptions, estimates and judgments on historical experience, current trends and other factors that management believes to be relevant at the time the consolidated financial statements are prepared. On a regular basis, management reviews the accounting policies, assumptions, estimates and judgments to ensure that our financial statements are presented fairly and in accordance with generally accepted accounting principles. However, because future events and their effects cannot be determined with certainty, actual results could differ from our assumptions and estimates, and such differences could be material.

Our significant accounting policies are discussed in note 1 of the Notes to Consolidated Financial Statements on page 47. Management believes that the following accounting policies are the most critical to aid in fully understanding and evaluating our reported financial results. Management has reviewed these critical accounting policies and related disclosures with our independent auditor and the Audit Committee of our Board of Directors.

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 may be exposed to losses in excess of our established reserves that could be material.

We also establish inventory loss reserves. Independent physical inventory counts are taken on a regular basis 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 a number of factors, including historical results and current inventory loss trends.

If our estimates regarding inventory losses are inaccurate, we may be exposed to losses in excess of our established reserves that could be material.

We have not made any material changes in the accounting methodology used to establish our markdown or inventory loss reserves during the past three years.

Long-Lived Assets

Long-lived assets such as property and equipment, intangible assets and investments are reviewed for impairment when events or changes in circumstances indicate the carrying value of the assets may not be recoverable. When evaluating long-lived assets for potential impairment, we first compare the carrying amount of the asset to the asset's estimated future cash flows (undiscounted and without interest charges). If the estimated future cash flows are less than the carrying amount of the asset, an impairment loss calculation is completed. The impairment loss calculation compares the carrying amount of the asset to the asset's estimated fair value, which may be based on future cash flows (discounted and with interest charges). An impairment loss is recorded if the amount of the asset's carrying value exceeds the asset's estimated fair value.

Our impairment loss calculation contains uncertainty because management must use judgment to forecast estimated fair values and to determine the useful lives of the assets. If actual results are not consistent with our assumptions and estimates regarding these factors, we may be exposed to losses that could be material.

Effective on March 3, 2002, we adopted SFAS No. 144. The adoption of SFAS No. 144 did not have a significant impact on our net earnings or financial position. For further discussion regarding the financial impact subsequent to adoption, see the Significant Accounting Matters section on page 22 and note 2 of the Notes to Consolidated Financial Statements on page 52.

Goodwill

We review goodwill for potential impairment annually and when events or changes in circumstances indicate the carrying value of the goodwill might exceed its current fair value. We determine fair value using widely accepted valuation techniques, including discounted cash flow and market multiple analyses. These types of analyses require us to make certain assumptions and estimates regarding industry economic factors and the profitability of future business strategies. It is our policy to conduct impairment testing based on our most current business strategy in light of present industry and economic conditions, as well as future expectations. If actual results are not consistent with our assumptions and estimates, we may be exposed to a goodwill impairment charge that could be material.

Effective on March 3, 2002, we adopted the provisions of SFAS No. 142, which eliminated the systematic amortization of goodwill. SFAS No. 142 also required that goodwill be reviewed for impairment at adoption and at least annually thereafter. For further discussion regarding the financial impact of the initial adoption, see the Significant Accounting Matters section on page 22 and note 1 of the Notes to Consolidated Financial Statements on page 51.

Costs Associated with Exit Activities

We adopted SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities,* on January 1, 2003. Since adoption, the present value of costs associated with location closings, primarily future lease costs, real estate taxes and common area maintenance, are charged to earnings when a location is vacated. When applicable, the liability is reduced by estimated future sublease income. Prior to our adoption of SFAS No. 146, a liability for location closings was recognized when management made the commitment to relocate or to close the location. The adoption of SFAS No. 146 did not have a significant impact on our net earnings or financial position.

The calculation of our location closing liability requires us to make assumptions and to apply judgment regarding the timing and duration of future vacancy periods, the amount and timing of future lump sum settlement payments, and the amount and timing of potential future sublease income.

When making these assumptions, we consider a number of factors, including historical settlement experience, the owner of the property, the location and condition of the property, the terms of the underlying lease, the specific marketplace demand and general economic conditions. If actual results are not consistent with our assumptions and judgments, we may be exposed to additional charges that could be material.

Extended Service Contract Liabilities

All of our extended service contracts are sold to customers on behalf of an unrelated third party, without recourse. However, we assumed a liability for certain self-insured extended service contracts when we acquired Future Shop in the third quarter of fiscal 2002. The remaining term of these extended service contracts vary by product and extend up to four years.

Liabilities have been established for the self-insured extended service contracts based on a number of factors, including historical trends in product failure rates and the expected material and labor costs necessary to provide the services. See note 11 in the Notes to Consolidated Financial Statements on page 63 for further discussion of the extended service contract liabilities.

The accounting for self-insured extended service contracts requires us to make assumptions and to apply judgment when estimating the product failure rates and expected material and labor costs necessary to provide the services. If actual results are not consistent with the assumptions and judgments used to calculate the extended service contract liability, we may be exposed to additional charges that could be material.

Self-Insured Liabilities

We are self-insured for certain losses related to health, workers' compensation and general liability insurance, although we maintain stop-loss coverage with third-party insurers to limit our total liability exposure.

When estimating our self-insurance liabilities, we consider a number of factors, including historical claims experience, demographic factors, severity factors and valuations provided by independent third-party actuaries. Periodically, management reviews its assumptions and the valuations provided by independent third-party actuaries to determine the adequacy of our self-insured liabilities. Our self-insured liabilities contain uncertainties because management must make assumptions and apply judgment to estimate the ultimate cost to settle reported claims and claims incurred but not reported as of the balance sheet date. If actual results differ from the assumptions and judgment we have used to calculate the self-insured liabilities, we may be exposed to additional charges that could be material.

We have not made any material changes in the accounting methodology used to establish our self-insured liabilities during the past three years.

Tax Contingencies

We are frequently audited by domestic and foreign tax authorities. 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, including state and local taxes, we record reserves for probable exposures. As of the end of fiscal 2003, three open tax years were undergoing examination by the United States Internal Revenue Service and two open years with Revenue Canada.

The estimate of our tax contingencies liability contains uncertainty because management must use judgment to estimate the exposure associated with our various filing positions. 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 could be materially impacted. Although management believes that the estimates discussed above are reasonable, actual results could differ from our estimates, and we may be exposed to a charge that could be material.

Pending Accounting Standards

A discussion of pending accounting standards is included in note 1 of the Notes to Consolidated Financial Statements on page 52.

Outlook for Fiscal 2004

Looking forward to fiscal 2004, we are projecting earnings growth from continuing operations of approximately 14% to 16%, with earnings per diluted share increasing from $1.91 per diluted share in fiscal 2003 to approximately $2.17 to $2.22 per diluted share in fiscal 2004. We expect the earnings growth to be driven by an 11% to 13% increase in revenue from continuing operations and an increase in our operating income rate to approximately 4.9% to 5.0% of revenue, compared with 4.8% in fiscal 2003. Due to the uncertainty regarding the timing of the planned sale of our interest in Musicland, our fiscal 2004 outlook excludes the financial impact of our discontinued operations. Our outlook is based on certain assumptions regarding future economic conditions and the geo-political environment. Differences in actual economic conditions or the geo-political environment compared with our assumptions could have a material impact on our fiscal 2004 operating results.

We are projecting fiscal 2004 revenue growth from continuing operations of approximately 11% to 13%, with revenue increasing from $20.9 billion in fiscal 2003 to approximately $23.5 billion in fiscal 2004. We expect new store growth and modest comparable store sales gains in the second half of fiscal 2004 will drive the revenue growth. For both our Domestic and International segments, we anticipate comparable store sales gains in the low single digits, fueled by consumer demand for digital products and an improved economic environment.

Our fiscal 2004 outlook reflects a modest improvement in our gross profit rate. The anticipated improvement is based on a more profitable revenue mix resulting from the expected increase in higher-margin digital product revenue. Digital product revenue is forecasted to increase to approximately 25% of our fiscal 2004 revenue mix, compared with 22% in fiscal 2003. In addition, planned improvements in inventory management, processing efficiencies and product sourcing initiatives are expected to contribute to the modest gross profit rate improvement. Our outlook assumes that the promotional levels in fiscal 2004 will be similar to those experienced in fiscal 2003.

Our fiscal 2004 SG&A rate is expected to remain essentially even with fiscal 2003. Continued improvements in the SG&A rate resulting from efficiency initiatives launched in the second half of fiscal 2003 are expected to offset higher depreciation and amortization expenses resulting from capital spending in fiscal 2003 and 2004.

We anticipate net interest expense for fiscal 2004 of approximately $10 million, compared with $4 million of net interest income in fiscal 2003 due to forecasted lower yields on our cash investments and reduced capitalized interest as a result of completing construction of our new corporate campus in the first quarter of fiscal 2004.

Our effective tax rate in fiscal 2004 is expected to be approximately 38.3%, slightly lower than our fiscal 2003 effective tax rate of 38.7%.

Capital expenditures in fiscal 2004 are expected to be approximately $700 million, exclusive of amounts expended on property development that will be recovered through the sale and lease back of the properties. The capital expenditures will support the opening of approximately 60 new U.S. Best Buy stores, with approximately half in our 45,000-square-foot format and the remainder in our smaller-market formats. Capital expenditure plans for our Domestic segment also include opening four new Magnolia Hi-Fi stores, remodeling three U.S. Best Buy stores and expanding one U.S. Best Buy store. Our International segment capital expenditure plans include opening 11 to 13 new Canadian Best Buy stores and four Future Shop stores, as well as relocating four Future Shop stores. Capital expenditures in fiscal 2004 also will include approximately $130 million in technology investments intended to improve our customer service capabilities and to increase operating efficiencies. The technology investments include the launch of a new platform for BestBuy.com, our online business associated with Best Buy stores, which will support initiatives aimed at improving the customer experience. Our technology investments are expected to remain relatively consistent over the next few fiscal years as we begin to leverage recently implemented systems.

Quarterly Results and Seasonality

Similar to many retailers, our business is seasonal. Revenue 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 for each quarter of fiscal 2003.

($ in millions, except per share amounts)

Quarter	1st	2nd	3rd	4th	Fiscal Year
Fiscal 2003 as revised[(1) (2)]					
Revenue	$ 4,202	$ 4,624	$ 5,131	$ 6,989	$ 20,946
Comparable store sales change[(3)]	6.5%	2.6%	0.7%	1.2%	2.4%
Gross profit	$ 1,080	$ 1,153	$ 1,250	$ 1,753	$ 5,236
Operating income	129	129	140	612	1,010
Earnings from continuing operations	79	79	86	378	622
Loss from discontinued operations, net of tax	(330)	(17)	(27)	(67)	(441)
Cumulative effect of change in accounting principle	(82)	—	—	—	(82)
Net (loss) earnings	(333)	62	59	311	99
Diluted (loss) earnings per share:					
Continuing operations	0.24	0.24	0.27	1.16	1.91
Discontinued operations	(1.01)	(0.05)	(0.08)	(0.21)	(1.36)
Cumulative effect of accounting changes	(0.25)	—	—	—	(0.25)
Diluted (loss) earnings per share	(1.02)	0.19	0.18	0.96	0.30

Quarter	1st	2nd	3rd
Fiscal 2003 as previously reported			
Revenue	$ 4,586	$ 5,008	$ 5,505
Comparable store sales change[(3)]	5.7%	2.0%	(0.4%)
Gross profit	$ 1,065	$ 1,129	$ 1,187
Operating income	115	103	139
Net earnings	70	62	85
Diluted earnings per share	0.22	0.19	0.26

Note: Certain totals may not add due to rounding.

(1) All quarters presented have been revised to reflect the classification of Musicland's financial results as discontinued operations. Refer to note 2 in the Notes to Consolidated Financial Statements beginning on page 52. First-quarter fiscal 2003 results include an after-tax, non-cash impairment charge of $308 for the full write-off of the goodwill related to our acquisition of Musicland. Fourth-quarter fiscal 2003 includes an after-tax, non-cash impairment charge of $102 related to a reassessment of the carrying value of Musicland's long-lived assets in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets.*

(2) Effective on March 3, 2002, we adopted SFAS No. 142, *Goodwill and Other Intangible Assets*. During the second quarter of fiscal 2003, we completed the required goodwill impairment testing and recognized an after-tax, non-cash impairment charge of $40 that is reflected in our revised fiscal 2003 first-quarter financial results as a cumulative effect of a change in accounting principle. Also effective on March 3, 2002, we changed our method of accounting for vendor

The following tables show selected unaudited quarterly operating results for each quarter of fiscal 2002.

($ in millions, except per share amounts)

Quarter	**1st**	**2nd**	**3rd**[4]	**4th**	**Fiscal Year**
Fiscal 2002 as revised[1]					
Revenue	$ 3,312	$ 3,768	$ 4,336	$ 6,295	$ 17,711
Comparable store sales change[3]	(3.1%)	2.8%	1.6%	4.5%	1.9%
Gross profit	$ 708	$ 806	$ 885	$ 1,371	$ 3,770
Operating income	101	157	146	504	908
Earnings from continuing operations	65	98	92	315	570
(Loss) earnings from discontinued operations, net of tax	(10)	(13)	(12)	35	—
Net earnings	55	85	80	350	570
Diluted earnings (loss) per share:[5]					
Continuing operations	0.20	0.30	0.29	0.97	1.77
Discontinued operations	(0.03)	(0.04)	(0.04)	0.11	—
Diluted earnings per share	0.17	0.26	0.25	1.08	1.77

Quarter	**1st**	**2nd**	**3rd**	**4th**	**Fiscal Year**
Fiscal 2002 as previously reported					
Revenue	$ 3,697	$ 4,164	$ 4,756	$ 6,980	$ 19,597
Comparable store sales change[3]	(3.1%)	2.8%	1.6%	4.5%	1.9%
Gross profit	$ 846	$ 948	$ 1,028	$ 1,608	$ 4,430
Operating income	90	148	129	570	937
Net earnings	55	85	80	350	570
Diluted earnings per share[5]	0.17	0.26	0.25	1.08	1.77

allowances to reflect the newly adopted accounting principle established in EITF Issue No. 02-16, *Accounting by a Reseller for Cash Consideration Received from a Vendor.* The related after-tax, non-cash charge of $42 also is reflected in our revised fiscal 2003 first-quarter financial results as a cumulative effect of a change in accounting principle. Refer to note 1 on page 51 in the Notes to Consolidated Financial Statements.

(3) Includes revenue at stores and Internet sites operating for at least 14 full months, as well as remodeled and expanded locations. Relocated stores are excluded from the comparable store sales calculation until at least 14 full months after reopening. Acquired stores are included in the comparable store sales calculation beginning with the first full quarter following the first anniversary of the date of acquisition. The calculation of the comparable store sales change excludes Musicland revenue, which is included in discontinued operations.

(4) 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.

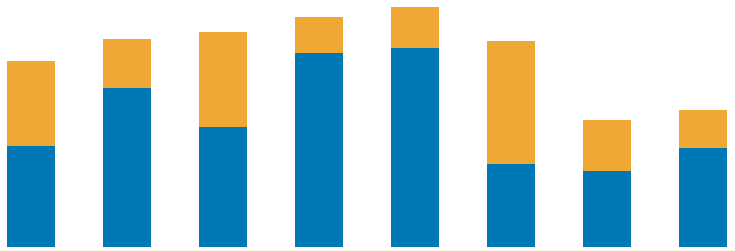
(5) The diluted earnings per share amounts have been revised to reflect a three-for-two stock split effected on May 10, 2002.

Common Stock Prices

The following table shows high and low prices of our common stock for each quarter of fiscal 2003 and 2002.

Quarter	1st	2nd	3rd	4th
Fiscal 2003				
High	$53.75	$46.10	$28.40	$30.45
Low	44.63	18.50	16.99	22.10
Fiscal 2002				
High	$41.57	$46.60	$48.00	$51.47
Low	22.42	35.45	26.68	43.43

Our common stock is traded on the New York Stock Exchange under the ticker symbol BBY. As of March 31, 2003, there were 2,345 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 revised to reflect a three-for-two stock split effected on May 10, 2002.



	02Q1	02Q2	02Q3	02Q4	03Q1	03Q2	03Q3	03Q4
High	$41.57	$46.60	$48.00	$51.47	$53.75	$46.10	$28.40	$30.45
Low	22.42	35.45	26.68	43.43	44.63	18.50	16.99	22.10

Common Stock Prices

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 January 10, 2003, that 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.