

Notes to Consolidated Financial Statements

\$ in millions, except per share amounts

1. Summary of Significant Accounting Policies

Description of Business

Best Buy Co., Inc. is a specialty retailer 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 is comprised of 104 Future Shop and eight Canadian Best Buy stores. Future Shop and Canadian Best Buy stores offer products similar to U.S. Best Buy stores. Future Shop operates in all Canadian provinces, while all of the Canadian Best Buy stores are in Ontario. Future Shop was acquired in the third quarter of fiscal 2002. As described in note 2, we have classified the results of operations of Musicland as discontinued operations. The Musicland business was previously included in our Domestic segment. The Notes to Consolidated Financial Statements, except where otherwise indicated, relate to continuing operations only. Musicland, principally a mall-based retailer of prerecorded home entertainment products, was acquired in the fourth quarter of fiscal 2001.

Basis of Presentation

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

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with generally accepted accounting principles requires us to make estimates and assumptions. These estimates and assumptions affect the reported

amounts in the consolidated balance sheets and statements of earnings, as well as the disclosure of contingent liabilities. Actual results could differ from these estimates and assumptions.

Fiscal Year

Our fiscal year ends on the Saturday nearest the end of February. Fiscal 2003 and 2002 each included 52 weeks, while fiscal 2001 included 53 weeks.

Cash and Cash Equivalents

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

Recoverable Costs from Developed Properties

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

Merchandise Inventories

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

Property and Equipment

Property and equipment are recorded at cost. We compute depreciation using the straight-line method over the estimated useful lives of the assets or, in the case of leasehold improvements, over the shorter of the estimated useful lives or lease terms.

Estimated useful lives by major asset category for continuing operations are as follows:

Asset	Life (in years)
Buildings	30 – 40
Leasehold improvements	10 – 25
Fixtures and equipment	3 – 15
Property under capital lease	5 – 35

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Impairment of Long-Lived Assets and Costs Associated with Exit Activities

In March 2002 we adopted Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, which requires long-lived assets, such as property and equipment, to be evaluated for impairment whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable. An impairment loss is recognized when estimated undiscounted cash flows expected to result from the use of the asset plus net proceeds expected from disposition of the asset (if any) are less than the carrying value of the asset. When an impairment loss is recognized, the carrying amount of the asset is reduced to its estimated fair value.

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, are charged to earnings when a location is vacated. Prior to adoption, we recognized a liability when we made the decision to relocate or close the location.

Goodwill and Intangible Assets

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

A reconciliation of reported earnings adjusted to reflect the adoption of SFAS No. 142, as if it were effective for all fiscal years presented, is provided below.

	2003	2002	2001
Reported earnings from continuing operations	\$ 622	\$ 570	\$ 401
Add back goodwill amortization, net of tax	—	2	1
Adjusted earnings from continuing operations	622	572	402
Reported loss from discontinued operations, net of tax	(441)	—	(5)
Add back goodwill amortization, net of tax	—	16	1
Adjusted (loss) earnings from discontinued operations	(441)	16	(4)
Cumulative effect of change in accounting principles, net of tax	(82)	—	—
Adjusted net earnings	\$ 99	\$ 588	\$ 398
Reported basic earnings per share from continuing operations	\$1.93	\$1.80	\$1.29
Add back goodwill amortization	—	0.01	—
Adjusted basic earnings per share from continuing operations	1.93	1.81	1.29
Reported basic loss per share from discontinued operations	(1.37)	—	(0.02)
Add back goodwill amortization	—	0.05	0.01
Adjusted basic (loss) earnings per share from discontinued operations	(1.37)	0.05	(0.01)
Cumulative effect of change in accounting principles	(0.25)	—	—
Adjusted basic earnings per share	\$0.31	\$1.86	\$1.28

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	2003	2002	2001
Reported diluted earnings per share from continuing operations	\$1.91	\$1.77	\$1.26
Add back goodwill amortization	—	0.01	—
Adjusted diluted earnings per share from continuing operations	1.91	1.78	1.26
Reported diluted loss per share from discontinued operations	(1.36)	—	(0.02)
Add back goodwill amortization	—	0.05	0.01
Adjusted diluted (loss) earnings per share from discontinued operations	(1.36)	0.05	(0.01)
Cumulative effect of change in accounting principles	(0.25)	—	—
Adjusted diluted earnings per share	\$0.30	\$1.83	\$1.25

During the second quarter of fiscal 2003, we completed the transitional requirements for goodwill impairment testing. As a result of the transitional goodwill impairment testing, we determined that the book value of the assets of our Musicland and Magnolia Hi-Fi businesses, which were acquired in the fourth quarter of fiscal 2001, exceeded their current fair values. We determine fair values utilizing widely accepted valuation techniques, including discounted cash flow and market multiple analyses. We based Musicland's fair value on the then-current expectations for the business in light of the existing retail environment and the uncertainty associated with future trends in prerecorded music products. We based Magnolia Hi-Fi's fair value on the then-current expectations for the business in light of recent sales trends and the then-existing business environment, including an economic

slowdown in the Pacific Northwest. The resulting after-tax, non-cash impairment charge was \$348, of which \$308 was associated with Musicland and \$40 was associated with Magnolia Hi-Fi. The charge represented a complete write-off of the goodwill associated with these businesses. As described in note 2, we have classified the results of operations of our Musicland subsidiary as discontinued operations, including the related goodwill impairment charge.

In the fourth quarter of fiscal 2003, we completed our annual impairment testing of goodwill related to our acquisition of Future Shop using the same techniques as described above, and determined there was no impairment.

The only significant identifiable intangible asset included in our balance sheet is an indefinite-lived intangible trade name related to Future Shop.

The changes in the carrying amount of goodwill by segment for continuing operations were as follows:

	Domestic	International	Total
Balances at Feb. 26, 2000	\$ —	\$ —	\$ —
Goodwill resulting from acquisitions	68	—	68
Systematic amortization of goodwill	(1)	—	(1)
Balances at March 3, 2001	67	—	67
Goodwill resulting from acquisitions	—	406	406
Systematic amortization of goodwill	(3)	—	(3)
Changes in foreign exchange rates	—	(5)	(5)
Balances at March 2, 2002	64	401	465
Goodwill resulting from acquisitions	3	—	3
Final purchase price allocation adjustment	—	(5)	(5)
Impairment charge	(64)	—	(64)
Changes in foreign exchange rates	—	30	30
Balances at March 1, 2003	\$ 3	\$426	\$429

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Foreign Currency

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

The effect of exchange rate fluctuations on translation of assets and liabilities is recorded as a component of shareholders' equity. Gains and losses from foreign currency transactions are included in selling, general and administrative expenses and have not been significant.

Revenue Recognition

We recognize revenue from the sale of merchandise at the time the merchandise is sold and the customer takes possession of the merchandise. We recognize service revenue at the time the service is provided, the sales price is fixed or determinable, and collectibility is reasonably assured. Gift card revenue is recognized when redeemed.

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

Sales Incentives

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

Shipping and Handling Costs

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

Vendor Allowances

We receive allowances from vendors as a result of purchasing and promoting their products. Vendor allowances provided as a reimbursement of specific, incremental and identifiable costs incurred to promote a vendor's products are recorded as an expense reduction when the cost is incurred.

Subsequent to fiscal 2002, all other vendor allowances, including vendor allowances received in excess of our cost to promote a vendor's product, or vendor allowances directly related to purchase of a vendor's product are initially deferred. The deferred amounts are then recorded as a reduction of cost of goods sold when the related product is sold. Prior to fiscal 2003, vendor allowances generally were recorded as a reduction of advertising expenses in SG&A (see note 1, Change in Accounting Principles – Goodwill and Vendor Allowances).

Stock-Based Compensation

In December 2002, the Financial Accounting Standards Board (FASB) issued SFAS No. 148, *Accounting for Stock-Based Compensation – Transition and Disclosure*. SFAS No. 148 amends SFAS No. 123, *Accounting for Stock-Based Compensation*, to provide alternative methods of transition for a voluntary change to the fair value-based method of accounting for stock-based employee compensation. In addition, SFAS No. 148 requires expanded and more prominent disclosure in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method on reported results.

We have stock-based employee compensation plans comprised primarily of fixed stock options. We have not adopted a method under SFAS No. 148 to expense stock options, but continue to apply Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations in accounting for these plans. Accordingly, no compensation expense has been recognized for stock option plans, as the exercise price equals the stock price on the date of grant.

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The table below illustrates the effect on net earnings and earnings per share as if we had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation for each of the last three fiscal years.

	2003	2002	2001
Net earnings, as reported	\$ 99	\$ 570	\$ 396
Add: Stock-based employee compensation expense included in reported net earnings, net of tax ⁽¹⁾	1	1	—
Deduct: Stock-based compensation expense determined under fair value method for all awards, net of tax	(85)	(59)	(44)
Net earnings, pro forma	\$ 15	\$ 512	\$ 352
Earnings per share:			
Basic – as reported	\$ 0.31	\$ 1.80	\$ 1.28
Basic – pro forma	\$ 0.05	\$ 1.62	\$ 1.14
Diluted – as reported	\$ 0.30	\$ 1.77	\$ 1.24
Diluted – pro forma	\$ 0.05	\$ 1.61	\$ 1.11

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

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

	2003	2002	2001
Risk-free interest rate	4.2%	4.9%	6.1%
Expected dividend yield	0%	0%	0%
Expected stock price volatility	60%	55%	60%
Expected life of stock options	5.0 years	4.5 years	4.5 years

The weighted average fair value of options granted during fiscal 2003, 2002 and 2001 used in computing pro forma compensation expense was \$23.91, \$18.60 and \$23.06 per share, respectively.

Pre-Opening Costs

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

Advertising Costs

Advertising costs, which are included in SG&A, are expensed the first time the advertisement runs. Gross advertising expenses, before expense reimbursement from vendor allowances, for fiscal 2003, 2002 and 2001 were \$567, \$493 and \$479, respectively, for continuing operations.

Derivative Financial Instruments

SFAS No.133, *Accounting for Derivative Instruments and Hedging Activities*, requires that all derivatives be recorded on the balance sheet at fair value. At March 1, 2003, the fair value of an existing interest-rate swap was not significant.

Change in Accounting Principles – Goodwill and Vendor Allowances

The adoption of SFAS No. 142 related to goodwill described above has been accounted for as a cumulative effect of a change in accounting principle and applied cumulatively as if the change had occurred at March 3, 2002, the beginning of fiscal 2003.

In September 2002, the Emerging Issues Task Force (EITF) released Issue No. 02-16, *Accounting by a Reseller for Cash Consideration Received from a Vendor*, with final consensus reached in March 2003. EITF No. 02-16 establishes the accounting standards for recording vendor allowances in a retailer's income statement.

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During fiscal 2003, we changed our method of accounting for vendor allowances in accordance with EITF No. 02-16. Based on the new standard, vendor allowances are considered a reduction in the price of a vendor's products or services and recorded as a component of cost of goods sold when the related product or service is sold, unless the allowance represents a reimbursement of a specific, incremental and identifiable cost incurred to sell a vendor's products or services. We continue to record vendor allowances that represent a reimbursement of a specific, incremental and identifiable cost incurred to sell a vendor's products or services as a reduction of the related cost in our statement of earnings. Previously, and in accordance with generally accepted accounting principles (GAAP), we had recognized and classified a majority of vendor allowances as a reduction of advertising costs in SG&A. The cumulative effect of the change in method of accounting for vendor allowances resulted in an after-tax, non-cash charge to net earnings of \$50, of which \$8 was associated with Musicland. The effect of the change on the fiscal year ended March 1, 2003, was a decrease in net earnings from continuing operations of \$1. As described in note 2, we have classified the results of operations of our Musicland subsidiary as discontinued operations, including the related cumulative effect of the change in accounting principle.

Reclassifications

Certain previous year amounts have been reclassified to conform to the current-year presentation. This included classifying the results of operations of Musicland as discontinued operations (see note 2). These reclassifications had no impact on net earnings, financial position or cash flows.

Pending Accounting Standards

In January 2003, the FASB issued Interpretation No. 46, *Consolidation of Variable Interest Entities* (FIN No. 46), which requires the consolidation of variable interest entities. FIN No. 46 is applicable to financial statements to be issued by us beginning with the second quarter of fiscal 2004. However, disclosures are required currently if we expect to consolidate any variable interest entities. At this time we do not believe that any variable interest entities will be included in our consolidated financial statements as a result of adopting FIN No. 46.

2. 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 classified the results of operations of Musicland in discontinued operations. The net assets associated with Musicland are currently considered "held-for-sale."

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

During the fourth quarter of fiscal 2003, in accordance with SFAS No. 144, we recorded an impairment charge of \$166 before tax related to a reassessment of the carrying value of Musicland's long-lived assets. We determined fair values utilizing widely accepted valuation techniques, including discounted cash flows. We based fair values on the then-current expectations for the business in light of the then-existing retail environment and the uncertainty associated with future trends in prerecorded music products.

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

For the Fiscal Years Ended	March 1, 2003	March 2, 2002	March 3, 2001
Revenue	\$ 1,727	\$ 1,886	\$ 138
Cost of goods sold	1,114	1,226	91
Gross profit	613	660	47
Selling, general and administrative expenses	685	631	54
Long-lived asset impairment charge	166	—	—
Operating (loss) income	(238)	29	(7)
Interest expense	(6)	(19)	(1)
(Loss) earnings before income taxes	(244)	10	(8)
Income tax (benefit) expense ⁽¹⁾	(119)	10	(3)
Loss before cumulative effect of change in accounting principles	(125)	—	(5)
Cumulative effect of change in accounting principle for goodwill (note 1), net of \$0 tax	(308)	—	—
Cumulative effect of change in accounting principle for vendor allowances (note 1), net of \$5 tax	(8)	—	—
Loss from discontinued operations, net of tax	\$ (441)	\$ —	\$ (5)

(1) Fiscal 2003 includes a \$25 tax benefit as described below.

The current and noncurrent assets and liabilities of Musicland as of March 1, 2003, and March 2, 2002, were as follows:

	March 1, 2003	March 2, 2002
Cash and cash equivalents	\$ 2	\$ —
Receivables	3	9
Merchandise inventories	316	383
Other current assets	76	56
Current assets of discontinued operations	\$ 397	\$ 448
Net property and equipment	\$ 69	\$ 236
Other assets	88	325
Noncurrent assets of discontinued operations	\$ 157	\$ 561
Accounts payable	\$ 208	\$ 282
Accrued compensation and related expenses	14	31
Accrued liabilities	98	105
Current liabilities of discontinued operations	\$ 320	\$ 418
Long-term liabilities	\$ 20	\$ 16
Long-term debt	5	5
Noncurrent liabilities of discontinued operations	\$ 25	\$ 21

We recorded a deferred tax asset of \$25 as of March 1, 2003, in conjunction with the classification of Musicland as discontinued operations. This tax benefit resulted from differences between the basis of assets and liabilities for financial reporting and income tax purposes arising at acquisition, which will be realized upon the disposition of Musicland. Although realization is not assured, we believe it is more likely than not that this deferred tax asset will be realized. Such differences also gave rise to a \$41 deferred tax asset associated with a capital loss carryover. We have provided a full valuation allowance against this \$41 deferred tax asset because of the uncertainties regarding realization of the benefit.

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3. Acquisitions

Effective Nov. 4, 2001, we acquired all of the common stock of Future Shop for \$377, or \$368 net of cash acquired, including transaction costs. We acquired Future Shop to further our expansion plans and to increase shareholder value. The acquisition was accounted for using the purchase method in accordance with SFAS No. 141, *Business Combinations*, issued in June 2001. Accordingly, we recorded the net assets at their estimated fair values, and included operating results in our financial statements from the date of acquisition. We allocated the purchase price on a preliminary basis using information then available. The allocation of the purchase price to the assets and liabilities acquired was finalized in the third quarter of fiscal 2003. The primary adjustments to the preliminary allocation were to assign value to the Future Shop trade name as a result of our decisions 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 is shown below and resulted in a \$5 decrease to goodwill from our preliminary allocation. All goodwill is nondeductible for tax purposes. Under SFAS No.142, goodwill is not amortized, but is reviewed for impairment at least annually.

The final purchase price allocation was as follows:

Merchandise inventories	\$169
Property and equipment	103
Goodwill	401
Intangible asset	32
Other assets	43
Current liabilities	(341)
Debt, including current portion	(13)
Other liabilities	(26)
Total	\$368

The following unaudited pro forma data sets forth the consolidated results of continuing operations as though Future Shop had been acquired as of the beginning of fiscal 2002:

	2002
Revenue	\$18,506
Net earnings	570
Basic earnings per share	1.80
Diluted earnings per share	1.77

The pro forma results include adjustments, principally the loss of interest income on cash used to finance the acquisition. The pro forma results exclude costs expected to be incurred in connection with the integration of Future Shop's business. The pro forma results are not necessarily indicative of what actually would have occurred had the acquisition been completed as of the beginning of fiscal 2002, nor are they necessarily indicative of future consolidated results.

4. Debt

	March 1, 2003	March 2, 2002
Convertible debentures, unsecured, due 2021, initial interest rate 2.75%	\$347	\$341
Convertible subordinated debentures, unsecured, due 2022, initial interest rate 2.25%	402	402
Senior subordinated notes, unsecured, due 2008, interest rate 9.9%	5	5
Master lease obligations, due 2006, interest rate 5.9%	59	39
Mortgage and other debt, interest rates ranging from 4.0% to 9.2%	21	33
Total debt	834	820
Less: current portion	(1)	(7)
Total long-term debt	833	813
Less: long-term debt included in discontinued operations	(5)	(5)
Long-term debt included in continuing operations	\$828	\$808

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The mortgage and other debt are secured by certain property and equipment with a net book value of \$30 and \$43 at March 1, 2003, and March 2, 2002, respectively.

Convertible Debentures

In January 2002, we sold convertible subordinated debentures having an aggregate principal amount of \$402. The proceeds from the offering, net of \$6 in offering expenses, were \$396. The debentures mature in 20 years and are callable at our option on or after January 15, 2007. Holders may require us to purchase all or a portion of their debentures on January 15, 2007; January 15, 2012; and January 15, 2017, at a purchase price equal to 100% of the principal amount of the debentures plus accrued and unpaid interest up to but not including the date of purchase. The debentures will be convertible into shares of our common stock at a conversion rate of 14.4927 shares per \$0.001 principal amount of debentures, equivalent to an initial conversion price of \$69.00 per share, if the closing price of our common stock exceeds a specified price for a specified period of time, or otherwise upon the occurrence of certain events. The debentures have an initial interest rate of 2.25% per annum. The interest rate may be reset, but not below 2.25% or above 3.25%, on July 15, 2006; July 15, 2011; and July 15, 2016.

In June 2001, we sold convertible debentures having an initial aggregate principal amount at maturity of \$492. The proceeds from the offering, net of \$7 in offering expenses, were \$330. The debentures mature in 20 years and are callable at our option on or after June 27, 2004. Holders may require us to purchase all or a portion of their debentures on June 27, 2004; June 27, 2009; and June 27, 2014, at a purchase price equal to the accreted value of the debentures plus accrued and unpaid cash interest up to but not including the date of purchase. The debentures will be convertible into shares of our common stock at a conversion rate of 11.8071 shares per \$0.001 initial principal amount at maturity of the debentures, equivalent to an initial conversion price of \$57.91

per share, if the closing price of our common stock exceeds a specified price for a specified period of time, or otherwise upon the occurrence of certain events. The debentures have an initial yield to maturity of 2.75% per annum, and a portion of the yield to maturity is paid as cash interest at the rate of 1.0% per annum. The yield to maturity may be reset, but not below 2.75% or above 3.75%, on December 27, 2003; December 27, 2008; and December 27, 2013.

Certain of our wholly owned subsidiaries have guaranteed the debentures on an unsecured and subordinated basis.

Credit Agreements

We have two credit agreements that provide bank revolving credit facilities under which we can borrow up to \$200 and \$37, respectively. Certain of our subsidiaries guarantee the \$200 facility. Best Buy Co., Inc. and a wholly owned subsidiary have guaranteed the \$37 facility. Outstanding letters of credit reduce amounts available under the agreements. The \$200 facility expires on March 21, 2005, and the \$37 facility expires on September 12, 2003. Borrowings under each of these facilities are unsecured and bear interest at rates specified in the credit agreements, as we have elected. We also pay certain facility and agent fees. The credit agreements contain covenants that require us to maintain certain financial ratios and minimum net worth. The \$200 agreement also requires that we have no outstanding principal balance for a period not less than 30 consecutive days.

As of March 1, 2003, and March 2, 2002, respectively, \$212 and \$221 were available under these two credit agreements. There were no borrowings outstanding under our \$200 facility for any period presented. The interest rates on amounts outstanding under the \$37 facility were 4.75% and 3.75% at March 1, 2003, and March 2, 2002, respectively.

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Master Lease

We have a master lease program which was used for the purpose of constructing and leasing new retail locations. At the end of fiscal 2003, \$59 in leases for 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. The lease is guaranteed by Best Buy Co., Inc.

Inventory Financing

We have a \$200 inventory financing line. Borrowings are collateralized by a security interest in certain merchandise inventories approximating the outstanding borrowings. The terms of this arrangement allow us to extend the due dates of invoices beyond their normal terms. The amounts extended generally bear interest at rates ranging from 1.5% below prime rate to 0.5% above prime rate. The prime rate was 4.25% and 4.75% as of March 1, 2003, and March 2, 2002, respectively. The line has provisions that give the financing source a portion of the cash discounts provided by the vendors. The inventory financing line is guaranteed by Best Buy Co., Inc. and one of its subsidiaries.

Amounts outstanding under this agreement are included in accounts payable in the balance sheet. As of March 1, 2003, and March 2, 2002, respectively, \$174 and \$157 was available under this agreement.

Other

The fair value of long-term debt approximates \$791 and \$829 as of March 1, 2003, and March 2, 2002, respectively. These fair values were based primarily on quotes from external sources.

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

Fiscal Year	
2004	\$ 1
2005 ⁽¹⁾	1
2006	61
2007 ⁽¹⁾	1
2008 ⁽²⁾	6
Thereafter	764
	<hr/> \$ 834

(1) Holders of our debentures may require us to purchase all or a portion of their debentures on June 27, 2004, and January 15, 2007, respectively. The potential purchases are not reflected in the table above. See note 4, Convertible Debentures, for additional details.

(2) Includes \$5 of senior subordinated notes due in 2008 related to Musicland, which has been classified as discontinued operations.

5. Shareholders' Equity

Stock Options

We sponsor three non-qualified stock option plans for our employees and our Board of Directors. These plans provide for the issuance of up to 73.2 million shares of common stock. Options may be granted only to employees or directors at exercise prices not less than the fair market value of our common stock on the date of the grant. All of the options have a 10-year term. Options issued pursuant to the 1997 employee plan vest over a four-year period. Options issued pursuant to the 1997 directors' plan vest immediately upon grant. At March 1, 2003, a total of 23.1 million shares were available for future grants under all plans.

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

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

	Shares	Weighted Average Exercise Price per Share
Outstanding on Feb. 26, 2000	25,569,000	\$ 11.26
Granted	8,070,000	45.53
Assumed ⁽¹⁾	461,000	37.21
Exercised	(5,720,000)	6.11
Canceled	(2,012,000)	26.94
Outstanding on March 3, 2001	26,368,000	22.13
Granted	9,382,000	37.01
Exercised	(6,846,000)	6.88
Canceled	(1,417,000)	35.98
Outstanding on March 2, 2002	27,487,000	30.29
Granted	14,253,000	44.06
Exercised	(2,850,000)	14.01
Canceled	(3,336,000)	43.65
Outstanding on March 1, 2003	35,554,000	\$ 35.89

⁽¹⁾ Represents Musicland options converted into Best Buy Co., Inc. options in connection with the acquisition of Musicland.

Exercisable options at the end of fiscal 2003, 2002 and 2001 were 13.4 million, 9.9 million and 9.4 million, respectively. The following table summarizes information concerning options outstanding and exercisable as of March 1, 2003:

Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
\$0 to \$10	2,154,000	4.40	\$ 2.08	2,021,000	\$ 2.22
\$10 to \$20	4,061,000	5.20	11.62	4,031,000	11.58
\$20 to \$30	4,633,000	9.75	28.40	138,000	25.69
\$30 to \$40	9,723,000	7.54	36.31	4,017,000	35.74
\$40 to \$50	6,191,000	7.25	46.65	3,042,000	46.66
\$50 to \$60	8,792,000	9.08	51.28	143,000	51.75
\$0 to \$60	35,554,000	7.70	\$35.89	13,392,000	\$25.96

\$ in millions, except per share amounts

Restricted Stock Plan

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

Earnings per Share

Basic earnings per share is computed based on the weighted average number of common shares outstanding. Diluted earnings per share is computed based on the weighted average number of common shares outstanding adjusted by the

number of additional shares that would have been outstanding had the potentially dilutive common shares been issued. Potentially dilutive shares of common stock include stock options; convertible debentures, assuming certain criteria are met (see note 4, Convertible Debentures); and other stock-based awards granted under stock-based compensation plans. The computation of dilutive shares excluded antidilutive outstanding stock options to purchase 24.6 million, 7.2 million and 7.2 million shares as of March 1, 2003; March 2, 2002; and March 3, 2001, respectively, because the exercise prices for those options were greater than the average market price of the common shares. The shares related to the convertible debentures were not included in our diluted earnings per share computation, as the criteria for conversion of the debentures were not met.

The following table presents a reconciliation of the numerators and denominators of basic and diluted earnings per common share from continuing operations for fiscal 2003, 2002 and 2001:

	2003	2002	2001
Numerator:			
Earnings from continuing operations	\$ 622	\$ 570	\$ 401
Denominator (in millions):			
Weighted average common shares outstanding	321.1	316.0	310.0
Effect of dilutive securities:			
Employee stock options	3.7	6.5	9.0
Weighted average common shares outstanding assuming dilution	324.8	322.5	319.0
Basic earnings per share – continuing operations	\$ 1.93	\$ 1.80	\$ 1.29
Diluted earnings per share – continuing operations	\$ 1.91	\$ 1.77	\$ 1.26

Repurchase of Common Stock

In fiscal 2000, our Board of Directors authorized the purchase of up to \$400 of our common stock from time to time through open market purchases. This

program has no stated expiration date. As of March 1, 2003, 2.9 million shares had been purchased and retired at a cost of \$100. No shares were purchased in fiscal 2003, 2002 or 2001.

\$ in millions, except per share amounts

6. Net Interest Income

Net interest income in fiscal 2003, 2002 and 2001 was comprised of the following:

	2003	2002	2001
Interest expense	\$ (30)	\$ (21)	\$ (7)
Loss on early retirement of debt	—	(8)	—
Capitalized interest	5	1	—
Interest income	23	27	44
Net interest (expense) income	(2)	(1)	37
Interest expense allocated to discontinued operations	(6)	(19)	(1)
Net interest income from continuing operations	\$ 4	\$ 18	\$ 38

We allocated interest expense to discontinued operations based upon debt that was attributable to the operations, including an \$8 loss on the early retirement of debt in fiscal 2002.

7. Operating Lease Commitments

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

leases provide us an early cancellation option if revenue for a specified period were not to reach a specified level as defined in the lease. Other leases contain covenants related to maintenance of financial ratios. Also, we lease certain equipment under operating leases. Transaction costs associated with the sale and lease back of properties and any gain or loss are recognized over the terms of the lease agreements. Proceeds from the sale and lease back of properties are included in the net change in recoverable costs from developed properties.

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

	2003	2002	2001
Minimum rentals	\$ 439	\$ 366	\$ 286
Percentage rentals	1	1	1
Total rent expense for continuing operations	\$ 440	\$ 367	\$ 287
Minimum rentals	\$ 144	\$ 152	\$ 13
Percentage rentals	1	1	—
Total rent expense for discontinued operations	\$ 145	\$ 153	\$ 13

Future minimum lease obligations, net of subleases rental income, by fiscal year (not including percentage rentals) for all operating leases at March 1, 2003, were as follows:

Fiscal Year	Continuing Operations	Discontinued Operations
2004	\$ 413	\$ 92
2005	395	89
2006	363	68
2007	347	54
2008	340	44
Thereafter	2,576	147

\$ in millions, except per share amounts

8. Benefit Plans

We sponsor retirement savings plans for employees meeting certain age and service requirements. The plans provide for Company-matching contributions, which are subject to annual approval by our Board of Directors. The total matching contributions were \$13, \$10 and \$7 in fiscal 2003, 2002 and 2001, respectively, for continuing operations.

We have a deferred compensation plan for certain management employees and our Board of

Directors. The liability for compensation deferred under this plan was \$42 and \$33 at March 1, 2003, and March 2, 2002, respectively, and is included in long-term liabilities of continuing operations. We have elected to match our liability under the plan through the purchase of life insurance. The cash value of the insurance, which includes funding for future deferrals, was \$51 and \$36 in fiscal 2003 and 2002, respectively, and is included in other assets from continuing operations. Both the asset and the liability are carried at fair value.

9. Income Taxes

The following is a reconciliation of income tax expense to the federal statutory tax rate for continuing operations for the past three fiscal years:

	2003	2002	2001
Federal income tax at the statutory rate	\$ 355	\$ 324	\$ 227
State income taxes, net of federal benefit	35	34	27
Tax-exempt interest income	(10)	(3)	(9)
Other	12	1	3
Income tax expense	\$ 392	\$ 356	\$ 248
Effective tax rate	38.7%	38.4%	38.3%

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

	2003	2002	2001
Current:			
Federal	\$ 375	\$ 301	\$ 187
State	51	39	25
Foreign	3	1	—
	429	341	212
Deferred:			
Federal	(22)	8	32
State	(3)	1	4
Foreign	(12)	6	—
	(37)	15	36
Income tax expense	\$ 392	\$ 356	\$ 248

\$ in millions, except per share amounts

Deferred taxes are the result of differences between the bases of assets and liabilities for financial reporting and income tax purposes. Deferred tax assets and liabilities from continuing operations as of the dates indicated were comprised of the following:

	March 1, 2003	March 2, 2002
Accrued expenses	\$ 83	\$ 55
Deferred revenue	25	14
Compensation and benefits	47	40
Inventory	26	—
Goodwill	23	—
Other	45	26
Total deferred tax assets	249	135
Property and equipment	154	149
Convertible debt	18	5
Other	6	18
Total deferred tax liabilities	178	172
Net deferred tax assets (liabilities)	\$ 71	\$ (37)

In connection with the cumulative effect of the changes in accounting principles, the Company realized an income tax benefit of \$50. In addition, the final Future Shop purchase price allocation included a \$19 deferred tax adjustment. As of March 1, 2003, we had Canadian net operating loss carryforwards of \$21, which expire through 2010. No valuation allowances have been recorded since we expect to utilize the carryforwards fully.

\$ in millions, except per share amounts

10. Segments

We operate two reportable segments: Domestic and International. The Domestic segment includes U.S. Best Buy and Magnolia Hi-Fi stores. The International segment is comprised of Future Shop and Canadian Best Buy stores. As described

in note 2, we have classified the results of operations of Musicland as discontinued operations. The Musicland business was previously included in our Domestic segment. The data included below were revised to exclude amounts related to Musicland.

The following tables present our business segment information for continuing operations for each of the past three fiscal years:

	2003	2002	2001
Revenue			
Domestic	\$ 19,303	\$ 17,115	\$ 15,189
International	1,643	596	—
Total revenue	\$ 20,946	\$ 17,711	\$ 15,189
Operating Income			
Domestic	\$ 1,002	\$ 886	\$ 611
International	8	22	—
Total operating income	1,010	908	611
Net interest income	4	18	38
Earnings from continuing operations before income tax expense	\$ 1,014	\$ 926	\$ 649
	2003	2002	2001
Assets			
Domestic	\$ 6,251	\$ 5,672	\$ 3,812
International	858	686	—
Total assets	\$ 7,109	\$ 6,358	\$ 3,812
Capital Expenditures			
Domestic	\$ 667	\$ 563	\$ 657
International	58	18	—
Total capital expenditures	\$ 725	\$ 581	\$ 657
Depreciation and Amortization			
Domestic	\$ 284	\$ 237	\$ 165
International	26	8	—
Total depreciation and amortization	\$ 310	\$ 245	\$ 165

\$ in millions, except per share amounts

11. Commitments and Contingencies

At the end of fiscal 2003, we had commitments for the purchase and construction of facilities valued at approximately \$20.

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

In November 2002, the FASB issued FIN No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*. FIN No. 45 provides guidance on the recognition and disclosure of certain types of guarantees, including product warranties. We assumed a liability for certain extended service contracts when we acquired Future Shop in the third quarter of fiscal 2002. Subsequent to the acquisition, extended service contracts were sold on behalf of an unrelated third party, without recourse. An accrued liability has been established for the acquired

extended service contracts based on historical trends in product failure rates and the expected material and labor costs necessary to provide the services. The remaining term of these extended service contracts varies by product and extend up to four years. The estimated remaining liability for extended service contracts at March 1, 2003, is \$28.

The following table reconciles the changes in our liability for extended service contracts for the year ended March 1, 2003:

Balance at March 2, 2002	\$ 17
Final purchase price allocation adjustment	37
Service charges	(28)
Foreign exchange	2
Balance at March 1, 2003	\$ 28

Leading with Integrity

Report of Best Buy Management

To Our Shareholders:

Our management is responsible for the preparation, integrity and objectivity of the accompanying consolidated financial statements and the related financial information. The financial statements have been prepared in conformity with generally accepted accounting principles and necessarily include certain amounts that are based on estimates and informed judgments.

We maintain a system of internal accounting controls that is designed to provide reasonable assurance as to the reliability of our financial records and the protection of our shareholders' interests. The concept of reasonable assurance is based on the recognition that the cost of a system of internal control should not exceed the related benefits. We believe our system provides the appropriate balance.

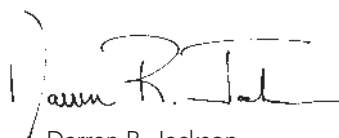
The Audit Committee of our Board of Directors, comprised of independent directors, further augments our system of internal controls. The Audit Committee oversees our system of internal controls, accounting practices, financial reporting and audits, and assesses whether their quality, integrity and objectivity are sufficient to protect shareholders' investments.

In addition, our independent auditor, whose report thereon appears on page 65, has audited the consolidated financial statements. Its role is to form an independent opinion as to the fairness with which such statements present our financial position and results of operations.

We believe the information contained in the accompanying consolidated financial statements and related financial information beginning on page 42 fairly presents, in all material respects, the financial condition and results of operations of our Company.



Bradbury H. Anderson
Vice Chairman
and CEO



Darren R. Jackson
Executive Vice President – Finance
and Chief Financial Officer

Auditor's Report

Independent Auditor's Report

Shareholders and Board of Directors

Best Buy Co., Inc.

We have audited the accompanying consolidated balance sheets of Best Buy Co., Inc. and subsidiaries as of March 1, 2003, and March 2, 2002, and the related consolidated statements of earnings, changes in shareholders' equity, and cash flows for each of the three years in the period ended March 1, 2003. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Best Buy Co., Inc. and subsidiaries at March 1, 2003, and March 2, 2002, and the consolidated results of their operations and their cash flows for each of the three years in the period ended March 1, 2003, in conformity with accounting principles generally accepted in the United States.

As discussed in Notes 1 and 2 to the consolidated financial statements, the Company changed its method of accounting for goodwill to conform to Statement of Financial Accounting Standards No. 142 and its method of accounting for cash consideration received from a vendor to conform to Emerging Issues Task Force No. 02-16 effective March 3, 2002, respectively.

Ernst & Young LLP

Minneapolis, Minnesota
April 1, 2003