BEST BUY CO INC
Form 10-Q
January 04, 2007

# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-Q

**(Mark One)**

| | |
|---|---|
| x | **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934** |

**For the quarterly period ended November 25, 2006**

**OR**

| | |
|---|---|
| o | **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934** |

**For the transition period from to**

**Commission File Number: 1-9595**

# BEST BUY CO., INC.

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **Minnesota** | **41-0907483** |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| **7601 Penn Avenue South**<br>**Richfield, Minnesota** | **55423** |
| (Address of principal executive offices) | (Zip Code) |

**(612) 291-1000**
(Registrant s telephone number, including area code)

**N/A**
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. **Yes** x **No** o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x Accelerated filer o Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). **Yes** o **No** x

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. **Yes o No o**

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date. Common Stock, $.10 Par Value 481,927,000 shares outstanding as of November 25, 2006.

BEST BUY CO., INC.

FORM 10-Q FOR THE QUARTER ENDED NOVEMBER 25, 2006

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PART I FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

BEST BUY CO., INC.

CONSOLIDATED CONDENSED BALANCE SHEETS

ASSETS

($ in millions, except per share amounts)

(Unaudited)

| | November 25, 2006 | February 25, 2006 | November 26, 2005 |
|---|---|---|---|
| CURRENT ASSETS | | | |
| Cash and cash equivalents | $ 1,202 | $ 748 | $ 812 |
| Short-term investments | 1,513 | 3,051 | 2,285 |
| Receivables | 1,112 | 439 | 883 |
| Merchandise inventories | 6,084 | 3,338 | 5,314 |
| Other current assets | 759 | 409 | 400 |
| Total current assets | 10,670 | 7,985 | 9,694 |
| | | | |
| PROPERTY AND EQUIPMENT | | | |
| Property and equipment | 5,427 | 4,836 | 4,658 |
| Less accumulated depreciation | 2,456 | 2,124 | 2,021 |
| Net property and equipment | 2,971 | 2,712 | 2,637 |
| | | | |
| GOODWILL | 991 | 557 | 546 |
| | | | |
| OTHER INTANGIBLE ASSETS | 83 | 44 | 46 |
| | | | |
| LONG-TERM INVESTMENTS | 320 | 218 | 114 |
| | | | |
| OTHER ASSETS | 351 | 348 | 205 |
| | | | |
| TOTAL ASSETS | $ 15,386 | $ 11,864 | $ 13,242 |

NOTE: The consolidated balance sheet as of February 25, 2006, has been condensed from the audited financial statements.

See Notes to Consolidated Condensed Financial Statements.

BEST BUY CO., INC.

CONSOLIDATED CONDENSED BALANCE SHEETS

LIABILITIES AND SHAREHOLDERS EQUITY

($ in millions, except per share amounts)

(Unaudited)

| | November 25, 2006 | February 25, 2006 | November 26, 2005 |
|---|---|---|---|
| CURRENT LIABILITIES | | | |
| Accounts payable | $ 6,332 | $ 3,234 | $ 5,325 |
| Unredeemed gift card liabilities | 429 | 469 | 374 |
| Accrued compensation and related expenses | 301 | 354 | 254 |
| Accrued liabilities | 1,315 | 878 | 1,157 |
| Accrued income taxes | 318 | 703 | 328 |
| Current portion of long-term debt | 459 | 418 | 17 |
| Total current liabilities | 9,154 | 6,056 | 7,455 |
| | | | |
| LONG-TERM LIABILITIES | 405 | 373 | 377 |
| | | | |
| LONG-TERM DEBT | 191 | 178 | 554 |
| | | | |
| MINORITY INTERESTS | 34 | | |
| | | | |
| SHAREHOLDERS EQUITY | | | |
| Preferred stock, $1.00 par value: Authorized 400,000 shares; Issued and outstanding none | | | |
| Common stock, $.10 par value: Authorized 1.5 billion shares; Issued and outstanding 481,927,000, 485,098,000 and 489,926,000 shares, respectively | 48 | 49 | 49 |
| Additional paid-in capital | 481 | 643 | 877 |
| Retained earnings | 4,793 | 4,304 | 3,699 |
| Accumulated other comprehensive income | 280 | 261 | 231 |
| Total shareholders equity | 5,602 | 5,257 | 4,856 |
| | | | |
| TOTAL LIABILITIES AND SHAREHOLDERS EQUITY | $ 15,386 | $ 11,864 | $ 13,242 |

NOTE: The consolidated balance sheet as of February 25, 2006, has been condensed from the audited financial statements.

See Notes to Consolidated Condensed Financial Statements.

BEST BUY CO., INC.

CONSOLIDATED STATEMENTS OF EARNINGS

($ in millions, except per share amounts)

(Unaudited)

| | Three Months Ended November 25, 2006 | November 26, 2005 | Nine Months Ended November 25, 2006 | November 26, 2005 |
|---|---|---|---|---|
| Revenue | $ 8,473 | $ 7,335 | $ 23,035 | $ 20,155 |
| Cost of goods sold | 6,478 | 5,547 | 17,373 | 15,098 |
| Gross profit | 1,995 | 1,788 | 5,662 | 5,057 |
| Selling, general and administrative expenses | 1,799 | 1,599 | 4,799 | 4,368 |
| Operating income | 196 | 189 | 863 | 689 |
| Net interest income | 24 | 14 | 68 | 45 |
| Earnings before income tax expense and minority interests | 220 | 203 | 931 | 734 |
| Income tax expense | 70 | 65 | 317 | 238 |
| Minority interests | | | | |
| Net earnings | $ 150 | $ 138 | $ 614 | $ 496 |
| Basic earnings per share | $ 0.31 | $ 0.28 | $ 1.27 | $ 1.01 |
| Diluted earnings per share | $ 0.31 | $ 0.28 | $ 1.24 | $ 0.99 |
| Dividends declared per common share | $ 0.10 | $ 0.08 | $ 0.26 | $ 0.23 |
| Basic weighted average common shares outstanding (in millions) | 481.0 | 491.1 | 482.5 | 491.2 |
| Diluted weighted average common shares outstanding (in millions) | 495.8 | 507.2 | 497.4 | 507.4 |

See Notes to Consolidated Condensed Financial Statements.

BEST BUY CO., INC.

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY

FOR THE NINE MONTHS ENDED NOVEMBER 25, 2006

($ and shares in millions)

(Unaudited)

| | **Common Shares** | **Common Stock** | **Additional Paid-In Capital** | **Retained Earnings** | **Accumulated Other Comprehensive Income** | **Total** |
|---|---|---|---|---|---|---|
| Balances at February 25, 2006 | 485 | $ 49 | $ 643 | $ 4,304 | $ 261 | $ 5,257 |
| | | | | | | |
| Net earnings, nine months ended November 25, 2006 | | | | 614 | | 614 |
| Other comprehensive income, net of tax: | | | | | | |
| Foreign currency translation adjustments | | | | | 20 | 20 |
| Other | | | | | (1 ) | (1 ) |
| Total comprehensive income | | | | | | 633 |
| | | | | | | |
| Stock options exercised | 5 | | 143 | | | 143 |
| Stock-based compensation | | | 87 | | | 87 |
| Tax benefits from stock options exercised and employee stock purchase plan | | | 43 | | | 43 |
| Issuance of common stock under employee stock purchase plan | 1 | | 48 | | | 48 |
| Repurchase of common stock | (9 ) | (1 ) | (483 ) | | | (484 ) |
| Common stock dividends, $0.26 per share | | | | (125 ) | | (125 ) |
| Balances at November 25, 2006 | 482 | $ 48 | $ 481 | $ 4,793 | $ 280 | $ 5,602 |

See Notes to Consolidated Condensed Financial Statements.

BEST BUY CO., INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

($ in millions)

(Unaudited)

| | Nine Months Ended November 25, 2006 | November 26, 2005 |
|---|---|---|
| OPERATING ACTIVITIES | | |
| Net earnings | $ 614 | $ 496 |
| Adjustments to reconcile net earnings to total cash provided by operating activities: | | |
| Depreciation | 369 | 333 |
| Asset impairment charges | 25 | |
| Stock-based compensation | 87 | 94 |
| Deferred income taxes | (29) | (54) |
| Excess tax benefits from stock-based compensation | (46) | (55) |
| Other | 12 | 12 |
| Changes in operating assets and liabilities, net of acquired assets and liabilities: | | |
| Receivables | (641) | (505) |
| Merchandise inventories | (2,597) | (2,443) |
| Other assets | (54) | (10) |
| Accounts payable | 2,595 | 2,487 |
| Other liabilities | 246 | 218 |
| Accrued income taxes | (324) | (193) |
| Total cash provided by operating activities | 257 | 380 |
| | | |
| INVESTING ACTIVITIES | | |
| Additions to property and equipment, net of $93 and $24 non-cash capital expenditures in the nine months ended November 25, 2006 and November 26, 2005, respectively | (520) | (497) |
| Acquisition of businesses, net of cash acquired | (421) | |
| Purchases of available-for-sale securities | (1,910) | (1,589) |
| Sales of available-for-sale securities | 3,341 | 2,328 |
| Proceeds from property dispositions | | 42 |
| Changes in restricted assets | (32) | 18 |
| Other, net | 8 | 18 |
| Total cash provided by investing activities | 466 | 320 |
| | | |
| FINANCING ACTIVITIES | | |
| Repurchase of common stock | (484) | (434) |
| Issuance of common stock under employee stock purchase plan and for the exercise of stock options | 191 | 228 |
| Dividends paid | (125) | (112) |
| Proceeds from issuance of long-term debt | 70 | 5 |
| Long-term debt payments | (62) | (68) |
| Excess tax benefits from stock-based compensation | 46 | 55 |
| Other, net | 87 | 72 |
| Total cash used in financing activities | (277) | (254) |
| | | |
| EFFECT OF EXCHANGE RATE CHANGES ON CASH | 8 | 12 |
| | | |
| INCREASE IN CASH AND CASH EQUIVALENTS | 454 | 458 |
| | | |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD | 748 | 354 |
| | | |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | $ 1,202 | $ 812 |

See Notes to Consolidated Condensed Financial Statements.

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BEST BUY CO., INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

1. Basis of Presentation:

In the opinion of management, the accompanying financial statements contain all adjustments necessary for a fair presentation as prescribed by accounting principles generally accepted in the United States. All adjustments were comprised of normal recurring adjustments, except as noted in the Notes to Consolidated Condensed Financial Statements. Due to the seasonal nature of our business, interim results are not necessarily indicative of results for the entire fiscal year. Our revenue and earnings are typically greater during our fiscal fourth quarter, which includes the majority of the holiday selling season. These interim financial statements and the related notes should be read in conjunction with the financial statements and notes included in our Annual Report on Form 10-K for the fiscal year ended February 25, 2006.

To maintain consistency with our accounting policies, we reclassified selected balances from receivables to cash and cash equivalents in our February 25, 2006, consolidated condensed balance sheet. This reclassification had no effect on previously reported operating income, net earnings or shareholders equity.

During the third quarter of fiscal 2007, we made a one-time election to adopt the transition method described in Financial Accounting Standards Board (FASB) Staff Position (FSP) No. FAS 123(R)-3, *Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards.* This election resulted in the reclassification of excess tax benefits as presented in the statement of cash flows, from operating activities to financing activities. See Note 7, *Stock-Based Compensation*, for further details. This reclassification had no effect on previously reported operating income, net earnings or shareholders equity.

Effective June 8, 2006, we acquired a 75% interest in Jiangsu Five Star Appliance Co., Ltd. (Five Star). Consistent with China s statutory requirements, Five Star s fiscal year ends on December 31. Therefore, we have elected to consolidate Five Star s financial results on a two-month lag. There were no significant intervening events that would have materially affected our consolidated financial statements had they been recorded during the quarter. See Note 2, *Acquisitions,* for further details regarding this transaction.

The following table illustrates the primary costs classified in each major expense category (the classification of which varies across the retail industry):

Cost of Goods Sold

- Total cost of products sold including:

  Freight expenses associated with moving merchandise inventories from our vendors to our distribution centers;

  Vendor allowances that are not a reimbursement of specific, incremental and identifiable costs to promote a vendor s products;

  Cash discounts on payments to vendors;

- Cost of services provided including:

  Payroll and benefits costs for services employees;

  Cost of replacement parts and related freight expenses;

- Physical inventory losses;
- Markdowns;
- Customer shipping and handling expenses;
- Costs associated with operating our distribution network, including payroll and benefit costs, occupancy costs, and depreciation;
- Freight expenses associated with moving merchandise inventories from our distribution centers to our retail stores; and
- Promotional financing costs.

**Selling, General & Administrative Expenses (SG&A)**

- Payroll and benefit costs for retail and corporate employees;
- Occupancy costs of retail, services and corporate facilities;
- Depreciation related to retail, services and corporate assets;
- Advertising;
- Vendor allowances that are a reimbursement of specific, incremental and identifiable SG&A costs to promote a vendor s products;
- Charitable contributions;
- Outside service fees;
- Long-lived asset impairment charges; and
- Other administrative costs, such as credit card service fees, supplies, and travel and lodging.

*Vendor Allowances*

The majority of vendor allowances are initially deferred and recorded as a reduction of merchandise inventories. The deferred amounts are then included as a reduction of cost of goods sold when the related product is sold.

Vendor allowances that are included in revenue for reimbursement of vendor-provided sales incentives and in SG&A for reimbursement of specific, incremental and identifiable SG&A costs to promote a vendor s products were as follows
($ in millions):

| | Three Months Ended November 25, 2006 | November 26, 2005 | Nine Months Ended November 25, 2006 | November 26, 2005 |
|---|---|---|---|---|
| Revenue | $ 5 | $ 36 | $ 17 | $ 77 |
| SG&A | $ 48 | $ 32 | $ 115 | $ 87 |

2. Acquisitions:

*Pacific Sales Kitchen and Bath Centers, Inc.*

Effective March 7, 2006, we acquired all of the common stock of Pacific Sales Kitchen and Bath Centers, Inc. (Pacific Sales) for $411 million, or $408 million, net of cash acquired, including transaction costs. We acquired Pacific Sales, a high-end home-improvement and appliance retailer, to enhance our ability to grow with an attractive customer base and premium brands using a proven and successful showroom format. Utilizing the existing store format, we expect to expand the number of stores in order to capitalize on the expanding high-end segment of the U.S. appliance market. The acquisition was accounted for using the purchase method in accordance with Statement of Financial Accounting Standards (SFAS) No. 141, *Business Combinations*. Accordingly, we recorded the net assets at their estimated fair values, and included operating results in our Domestic segment from the date of acquisition. We allocated the purchase price on a preliminary basis using information currently available. The allocation of the purchase price to the assets and liabilities acquired will be finalized no later than the first quarter of fiscal 2008, as we obtain more information regarding asset valuations, liabilities assumed and revisions of preliminary estimates of fair values made at the date of purchase. All goodwill is deductible for tax purposes.

The preliminary purchase price allocation, net of cash acquired, was as follows ($ in millions):

| | |
|---|---|
| Merchandise inventories | |