BEST BUY CO INC
Form 10-Q
October 05, 2006

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 August 26, 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 **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 an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). **Yes x No 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 480,250,000 shares outstanding as of August 26, 2006.

BEST BUY CO., INC.

FORM 10-Q FOR THE QUARTER ENDED AUGUST 26, 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)

	August 26, 2006	February 25, 2006	August 27, 2005
CURRENT ASSETS			
Cash and cash equivalents	$ 1,104	$ 748	$ 614
Short-term investments	1,564	3,051	2,211
Receivables	483	439	389
Merchandise inventories	4,049	3,338	3,250
Other current assets	687	409	378
Total current assets	7,887	7,985	6,842
PROPERTY AND EQUIPMENT			
Property and equipment	5,151	4,836	4,436
Less accumulated depreciation	2,364	2,124	1,913
Net property and equipment	2,787	2,712	2,523
GOODWILL	1,010	557	529
OTHER INTANGIBLE ASSETS	83	44	42
LONG-TERM INVESTMENTS	277	218	122
OTHER ASSETS	363	348	201
TOTAL ASSETS	$ 12,407	$ 11,864	$ 10,259

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)

	August 26, 2006	February 25, 2006	August 27, 2005
CURRENT LIABILITIES			
Accounts payable	$ 3,858	$ 3,234	$ 2,760
Unredeemed gift card liabilities	392	469	358
Accrued compensation and related expenses	263	354	216
Accrued liabilities	958	878	916
Accrued income taxes	399	703	254
Current portion of long-term debt	496	418	12
Total current liabilities	6,366	6,056	4,516
LONG-TERM LIABILITIES	392	373	380
LONG-TERM DEBT	184	178	540
MINORITY INTERESTS	31		
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 480,250,000, 485,098,000 and 492,444,000 shares, respectively	48	49	49
Additional paid-in capital	389	643	973
Retained earnings	4,690	4,304	3,600
Accumulated other comprehensive income	307	261	201
Total shareholders equity	5,434	5,257	4,823
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$ 12,407	$ 11,864	$ 10,259

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.

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BEST BUY CO., INC.

CONSOLIDATED STATEMENTS OF EARNINGS

($ in millions, except per share amounts)

(Unaudited)

	Three Months Ended August 26, 2006	August 27, 2005	Six Months Ended August 26, 2006	August 27, 2005
Revenue	$ 7,603	$ 6,702	$ 14,562	$ 12,820
Cost of goods sold	5,701	4,991	10,895	9,551
Gross profit	1,902	1,711	3,667	3,269
Selling, general and administrative expenses	1,572	1,450	3,000	2,769
Operating income	330	261	667	500
Net interest income	21	18	44	31
Earnings before income tax expense and minority interests	351	279	711	531
Income tax expense	121	91	247	173
Minority interests				
Net earnings	$ 230	$ 188	$ 464	$ 358
Basic earnings per share	$ 0.48	$ 0.38	$ 0.96	$ 0.73
Diluted earnings per share	$ 0.47	$ 0.37	$ 0.94	$ 0.71
Dividends declared per common share	$ 0.08	$ 0.07	$ 0.16	$ 0.15
Basic weighted average common shares outstanding (in millions)	482.0	491.2	483.3	491.2
Diluted weighted average common shares outstanding (in millions)	496.5	509.1	498.4	507.5

See Notes to Consolidated Condensed Financial Statements.

BEST BUY CO., INC.

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY

FOR THE SIX MONTHS ENDED AUGUST 26, 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, six months ended August 26, 2006				464		464
Other comprehensive income, net of tax:						
Foreign currency translation adjustments					51	51
Other					(5)	(5)
Total comprehensive income						510
Stock options exercised	4		94			94
Stock-based compensation			59			59
Tax benefits from stock options exercised and employee stock purchase plan			31			31
Issuance of common stock under employee stock purchase plan			23			23
Repurchase of common stock	(9)	(1)	(461)			(462)
Common stock dividend, $0.16 per share				(78)		(78)
Balances at August 26, 2006	480	$ 48	$ 389	$ 4,690	$ 307	$ 5,434

See Notes to Consolidated Condensed Financial Statements.

BEST BUY CO., INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

($ in millions)

(Unaudited)

	Six Months Ended August 26, 2006	August 27, 2005
OPERATING ACTIVITIES		
Net earnings	$ 464	$ 358
Adjustments to reconcile net earnings to total cash used in operating activities:		
Depreciation	246	222
Asset impairment charges	21	
Stock-based compensation	59	62
Deferred income taxes	(28)	(31)
Excess tax benefits from stock-based compensation	(22)	(21)
Other	14	(1)
Changes in operating assets and liabilities, net of acquired assets and liabilities:		
Receivables	(15)	(13)
Merchandise inventories	(548)	(385)
Other assets	(5)	(21)
Accounts payable	231	(75)
Other liabilities	(185)	(19)
Accrued income taxes	(263)	(273)
Total cash used in operating activities	(31)	(197)
INVESTING ACTIVITIES		
Additions to property and equipment, net of $23 non-cash capital expenditures in the six months ended August 27, 2005	(299)	(280)
Acquisition of businesses, net of cash acquired	(421)	
Purchases of available-for-sale securities	(1,635)	(995)
Sales of available-for-sale securities	3,060	1,805
Proceeds from property dispositions		42
Changes in restricted assets	(16)	12
Other, net	12	10
Total cash provided by investing activities	701	594
FINANCING ACTIVITIES		
Repurchase of common stock	(462)	(262)
Issuance of common stock under employee stock purchase plan and for the exercise of stock options	117	187
Dividends paid	(78)	(73)
Long-term debt payments	(7)	(66)
Proceeds from issuance of long-term debt	38	7
Excess tax benefits from stock-based compensation	22	21
Other, net	37	37
Total cash used in financing activities	(333)	(149)
EFFECT OF EXCHANGE RATE CHANGES ON CASH	19	12
INCREASE IN CASH AND CASH EQUIVALENTS	356	260
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	748	354
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 1,104	$ 614

See Notes to Consolidated Condensed Financial Statements.

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 and comparability, we reclassified certain prior-year amounts to conform to the current year presentation as described in Note 1, *Summary of Significant Accounting Policies*, of the Notes to Consolidated Financial Statements in our Annual Report on Form 10-K for the fiscal year ended February 25, 2006. In addition, to be consistent with our accounting policies, we reclassified selected balances from receivables to cash and cash equivalents in our February 25, 2006, consolidated condensed balance sheet. These reclassifications 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 decided to consolidate Five Star s financial results on a two-month lag. There were no significant intervening events which 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;

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 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

- 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.

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service fees, supplies, and travel and lodging.

Vendor allowances included in revenue for reimbursement of vendor-provided sales incentives were $6 million and $24 million, for the three months ended August 26, 2006, and August 27, 2005, respectively, and $12 million and $41 million, for the six months ended August 26, 2006, and August 27, 2005, respectively. Vendor allowances included in SG&A were $38 million and $35 million for the three months ended August 26, 2006, and August 27, 2005, respectively, and $67 million and $55 million for the six months ended August 26, 2006, and August 27, 2005, respectively. All remaining 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.

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 rapidly growing 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	$ 41
Property and equipment	2
Other assets(1)	14
Tradename	17
Goodwill	377
Current liabilities	(43)
	$ 408

(1) Includes $7 million related to the acquired customer backlog.

Jiangsu Five Star Appliance Co., Ltd.

Effective June 8, 2006, we acquired a 75% interest in Five Star for $184 million, including a working capital injection of $122 million and transaction costs. Five Star is one of China s largest appliance and consumer electronics retailers with 131 stores located in eight of China s 34 provinces. We made the investment in Five Star to further our international growth plans, increase our knowledge of Chinese customers and obtain an immediate retail presence in China. The acquisition was accounted for using the purchase method in accordance with SFAS No. 141, *Business Combinations*. Accordingly, we recorded the net assets at their estimated fair values, and included operating results in our International 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 second 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. The resulting goodwill is not deductible for tax purposes.

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

Restricted cash	$ 204
Merchandise inventories	107
Property and equipment	37
Other assets	81
Tradename	21
Goodwill	69
Accounts payable	(363)
Other current liabilities	(47)
Debt, due 2006 to 2007, interest rates ranging from 1.9% to 6.8%	(64)
Long-term liabilities	(1)
Minority interests (1)	(31)
	$ 13

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(1) The minority interests proportionate ownership of assets and liabilities were recorded at historical carrying values.

The minority interests share of net earnings included in the three and six months ended August 26, 2006, was less than $1 million.

3. Gift Cards:

We sell gift cards to our customers in our retail stores, through our Web sites and through selected third parties. Our gift cards do not have an expiration date. We recognize income from gift cards when: (i) the gift card is redeemed by the customer; or (ii) the likelihood of the gift card being redeemed by the customer is remote (gift card breakage) and we determine that we do not have a legal obligation to remit the value of unredeemed gift cards to the relevant jurisdictions. We determine our gift card breakage rate based upon historical redemption patterns. Based on our historical information, the likelihood of a gift card remaining unredeemed can be determined 24 months after the gift card is issued. At that time, we recognize breakage income for those cards for which the likelihood of redemption is deemed to be remote if we do not have a legal obligation to remit the value of such unredeemed gift cards to the relevant jurisdictions. Gift card breakage income is included in revenue in our consolidated statements of earnings.

Gift card breakage income recognized for the three and six months ended August 26, 2006 was not significant (less than $0.01 per diluted share). There was no gift card breakage income recognized for the three and six months ended August 27, 2005.

4. Net Interest Income:

Net interest income was comprised of the following ($ in millions):

	Three Months Ended		**Six Months Ended**	
	August 26, 2006	**August 27, 2005**	**August 26, 2006**	**August 27, 2005**
Interest income	$ 29	$ 21	$ 60	$ 42
Dividend income		4		4
Interest expense	(8)	(7)	(16)	(15)
Net interest income	$ 21	$ 18	$ 44	$ 31

5. 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 non-qualified stock options, nonvested share awards and shares issuable under our employee stock purchase plan (ESPP), as well as common shares that would have resulted from the assumed conversion of our convertible debentures. Since the potentially dilutive shares related to the convertible debentures are included in the calculation, the related interest expense, net of tax, is added back to net earnings, as the interest would not have been paid if the convertible debentures were converted to common stock. Nonvested market-based awards and nonvested performance-based awards are included in the average diluted shares outstanding each period if established market or performance criteria have been met.

The following table presents a reconciliation of the numerators and denominators of basic and diluted earnings per share ($ and shares in millions, except per share amounts):

	Three Months Ended August 26, 2006	**August 27, 2005**	**Six Months Ended August 26, 2006**	**August 27, 2005**
Numerator:				
Net earnings, basic	$ 230	$ 188	$ 464	$ 358
Adjustment for assumed dilution:				
Interest on convertible debentures, net of tax	1	1	3	3
Net earnings, diluted	$ 231	$ 189	$ 467	$ 361
Denominator:				
Weighted-average common shares outstanding	482.0	491.2	483.3	491.2
Effect of potentially dilutive securities:				
Shares from assumed conversion of convertible debentures	8.8	8.8	8.8	8.8
Stock options and other	5.7	9.1	6.3	7.5
Weighted-average common shares outstanding, assuming dilution	496.5	509.1	498.4	507.5
Basic earnings per share	$ 0.48	$ 0.38	$ 0.96	$ 0.73
Diluted earnings per share	$ 0.47	$ 0.37	$ 0.94	$ 0.71

The computation of average dilutive shares outstanding excluded non-qualified options to purchase 0.4 million shares of common stock for the three months ended August 26, 2006, and 0.4 million and 0.2 million shares of common stock for the six months ended August 26, 2006, and August 27, 2005, respectively. These amounts were excluded as the options exercise prices were greater than the average market price of our common stock for the periods presented and, therefore, the effect would be antidilutive (i.e., including such options would result in higher earnings per share). There were no options excluded from the computation of dilutive shares outstanding for the three months ended August 27, 2005.

6. Stock-Based Compensation:

Stock-based compensation expense was $31 million for both the three months ended August 26, 2006, and August 27, 2005, and $59 million and $62 million for the six months ended August 26, 2006, and August 27, 2005, respectively. The year-to-date decline was due to an increase in our participant forfeiture rate resulting from recent workforce reductions. Stock-based compensation expense for the six months ended August 26, 2006, may not be indicative of the expense for the entire fiscal year.

7. Comprehensive Income:

Comprehensive income is computed as net earnings plus certain other items that are recorded directly to shareholders equity. The significant components of comprehensive income include foreign currency translation adjustments and unrealized gains/losses net of tax on available-for-sale marketable equity securities. Foreign currency translation adjustments do not include a provision for income tax expense because earnings from foreign operations are considered to be indefinitely reinvested outside the United States. Comprehensive income was $222 million and $253 million for the three months ended August 26, 2006, and August 27, 2005, respectively, and $510 million and $410 million for the six months ended August 26, 2006, and August 27, 2005, respectively.

8. Segments:

We operate two reportable segments: Domestic and International. The Domestic segment is comprised of all U.S. store and online operations, including Best Buy, Geek Squad, Pacific Sales and Magnolia Audio Video. The International segment is comprised of all Canadian store and online operations, including Future Shop, Best Buy and Geek Squad, as well as our Five Star store and online operations in China. Our segments are evaluated on an operating income basis, and a stand-alone tax provision is not calculated for each segment. The other accounting policies of the segments are the same as those described in Note 1, *Summary of Significant Accounting Policies*, in the Notes to Consolidated Financial Statements included in our Annual Report on Form 10-K for the fiscal year ended February 25, 2006.

Revenue by reportable segment was as follows ($ in millions):

	Three Months Ended		**Six Months Ended**	
	August 26, 2006	**August 27, 2005**	**August 26, 2006**	**August 27, 2005**
Domestic	$ 6,621	$ 5,997	$ 12,783	$ 11,489
International	982	705	1,779	1,331
Total revenue	$ 7,603	$ 6,702	$ 14,562	$ 12,820

Operating income by reportable segment and the reconciliation to earnings before income tax expense and minority interests were as follows ($ in millions):

	Three Months Ended		**Six Months Ended**	
	August 26, 2006	**August 27, 2005**	**August 26, 2006**	**August 27, 2005**
Domestic	$ 328	$ 255	$ 661	$ 497
International	2	6	6	3
Total operating income	330	261	667	500
Net interest income	21	18	44	31
Earnings before income tax expense and minority interests	$ 351	$ 279	$ 711	$ 531

Assets by reportable segment were as follows ($ in millions):

	August 26, 2006	**February 25, 2006**	**August 27, 2005**
Domestic	$ 9,315	$ 9,722	$ 8,316
International	3,092	2,142	1,943
Total assets	$ 12,407	$ 11,864	$ 10,259

Goodwill by reportable segment was as follows ($ in millions):

	August 26, 2006		February 25, 2006		August 27, 2005	
Domestic	$	383	$	6	$	3
International	627		551		526	
Total goodwill	$	1,010	$	557	$	529

The change in the Domestic goodwill balance since February 25, 2006, was the result of the acquisition of Pacific Sales. The change in the International goodwill balance since February 25, 2006, and August 27, 2005, was due primarily to the acquisition of Five Star totaling $69 million, with the remainder due primarily to fluctuations in foreign currency exchange rates.

Other intangible assets included in our balance sheets were comprised primarily of indefinite-lived intangible tradename assets related to Pacific Sales, which is included in the Domestic segment, and Future Shop and Five Star, which are included in the International segment. Other intangible assets by reportable segment were as follows ($ in millions):

	August 26, 2006		February 25, 2006		August 27, 2005	
Domestic	$	17	$		$	
International	66		44		42	
Total other intangible assets	$	83	$	44	$	42

9. Investments:

Debt Securities

Short-term and long-term investments are comprised of municipal and United States government debt securities, as well as auction-rate securities. In accordance with SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, and based on our ability to market and sell these instruments, we classify auction-rate securities, variable-rate demand notes and other investments in debt securities as available-for-sale and carry them at amortized cost, which approximates fair value. Auction-rate securities and variable-rate demand notes are similar to short-term debt instruments because their interest rates are reset periodically. Investments in these securities can be sold for cash on the auction date. We classify auction-rate securities and variable-rate demand notes as short-term or long-term investments based on the reset dates.

In accordance with our investment policy, we place our investments in debt securities with issuers who have high-quality credit and limit the amount of investment exposure to any one issuer. We seek to preserve principal and minimize exposure to interest-rate fluctuations by limiting default risk, market risk and reinvestment risk.

During the third quarter of fiscal 2006, we reclassified variable-rate demand notes from cash and cash equivalents to short-term investments for all periods presented. The amortized cost of the securities reclassified was $184 million at August 27, 2005.

We also revised the presentation in the consolidated statement of cash flows for the six months ended August 27, 2005, to reflect the gross purchases and sales of variable-rate demand notes as investing activities rather than as a component of cash and cash equivalents, which is consistent with the presentation for the six months ended August 26, 2006. The amount reclassified from cash and cash equivalents to investing activities was $68 million for the six months ended August 27, 2005.

The carrying amount of our investments in debt securities approximated fair value at August 26, 2006; February 25, 2006; and August 27, 2005, due to the rapid turnover of our portfolio and the highly liquid nature of these investments. Therefore, there were no significant unrealized holding gains or losses.

The following table presents the amortized principal amounts, related weighted-average interest rates (taxable equivalent), maturities and major security types for our investments in debt securities ($ in millions):

	August 26, 2006		February 25, 2006		August 27, 2005	
	Amortized Principal Amount	**Weighted-Average Interest Rate**	**Amortized Principal Amount**	**Weighted-Average Interest Rate**	**Amortized Principal Amount**	**Weighted-Average Interest Rate**
Short-term investments (less than one year)	$ 1,564	5.62 %	$ 3,051	4.76 %	$ 2,211	3.95 %
Long-term investments (one to three years)	277	5.74 %	218	4.95 %	122	3.95 %
Total	$ 1,841		$ 3,269		$ 2,333	
Municipal debt securities	$ 1,736		$ 3,153		$ 2,209	
Auction-rate and asset-backed securities	105		109		117	
Debt securities issued by U.S. Treasury and other U.S. government entities			7		7	
Total	$ 1,841		$ 3,269		$ 2,333	

Equity Securities

We also hold investments in equity securities. We classify all marketable equity securities as available-for-sale. Investments in marketable equity securities are included in other assets in our consolidated balance sheets and reported at fair value, based on quoted market prices when available. All unrealized holding gains or losses are reflected net of tax in accumulated other comprehensive income in shareholders equity.

The carrying value of our investments in equity securities at August 26, 2006; February 25, 2006; and August 27, 2005, was $29 million, $28 million and $28 million, respectively. Net unrealized gains, net of tax, included in accumulated other comprehensive income were $7 million, $12 million and $12 million at August 26, 2006; February 25, 2006; and August 27, 2005, respectively.

10. Restricted Assets:

Restricted cash and investments in debt securities, which are included in other current assets, totaled $398 million, $178 million and $146 million as of August 26, 2006; February 25, 2006; and August 27, 2005, respectively. Such balances are pledged as collateral or restricted to use for general liability insurance, workers compensation insurance, warranty programs and vendor payables. The increase in restricted cash and investments in debt securities compared with February 25, 2006, and August 27, 2005, was due primarily to restricted cash assumed in connection with the acquisition of Five Star.

11. Impairment of Long-Lived Assets:

We recorded pre-tax long-lived asset impairment charges of $9 million and $21 million for the three and six months ended August 26, 2006, respectively. Long-lived asset impairment charges for the three and six months ended August 25, 2005 were not significant. The long-lived asset impairment charges in fiscal 2007 related to assets that were taken out of service based on changes in our business. Long-lived asset impairment charges recorded in SG&A within our Domestic segment during the second quarter and first six months of fiscal 2007 were $7 million and $19 million, respectively. Long-lived asset impairment charges recorded in SG&A within our International segment during both the second quarter and first six months of fiscal 2007 were $2 million.

12. Commitments and Contingencies:

On December 8, 2005, a purported class action lawsuit captioned, *Jasmen Holloway, et al. v. Best Buy Co., Inc.,* was filed against us in the U.S. District Court for the Northern District of California. This federal court action alleges that we discriminate against women and minority individuals on the basis of gender, race, color and/or national origin in our stores with respect to recruitment, hiring, job assignments, transfers, promotions, compensation, allocation of weekly hours and other terms and conditions of employment. The plaintiffs seek an end to discriminatory policies and practices, an award of back and front pay, punitive damages and injunctive relief, including rightful place relief for all class members. We believe the allegations are without merit and intend to defend this action vigorously.

We are involved in various other legal proceedings arising in the normal course of conducting business. We believe the amounts provided in our consolidated financial statements are adequate in light of the probable and estimable liabilities. The resolution of those proceedings is not expected to have a material effect on our results of operations or financial condition.

13. Common Stock Repurchases:

Our Board of Directors (Board) authorized a $1.5 billion share repurchase program in June 2006. The program, which was announced on June 21, 2006, terminated and replaced a $1.5 billion share repurchase program authorized by our Board in April 2005. The April 2005 share repurchase program terminated and replaced a $500 million share repurchase program authorized by our Board in June 2004. There is no expiration date governing the period over which we can make our share repurchases under the June 2006 share repurchase program.

For the three months ended August 26, 2006, we purchased and retired 2.8 million shares at a cost of $130 million under our June 2006 share repurchase program. For the three and six months ended August 26, 2006, we also purchased and retired 1.8 million and 6.2 million shares, respectively, at a cost of $94 million and $332 million under our April 2005 share repurchase program.

For the three and six months ended August 27, 2005, we purchased and retired 1.1 million and 5.3 million shares, respectively, at a cost of $54 million and $200 million under our April 2005 share repurchase program, and 1.8 million shares at a cost of $61 million under our $500 million share repurchase program during the period from February 27, 2005, through April 26, 2005.

14. New Accounting Pronouncements

In October 2005, the Financial Accounting Standards Board (FASB) issued Staff Position (FSP) No. FAS 13-1, *Accounting for Rental Costs Incurred During a Construction Period.* FSP No. FAS 13-1 requires companies to expense rent payments for building or ground leases incurred during the construction period. FSP No. FAS 13-1 is effective for all interim and annual reporting periods beginning after December 15, 2005. Retrospective application is permitted, but not required. We adopted FSP No. FAS 13-1 on a prospective basis in the first quarter of fiscal 2007. The adoption of FSP No. FAS 13-1 did not have a significant effect on our operating income or net earnings.

In July 2006, the FASB issued Financial Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109.* FIN No. 48 provides guidance regarding the recognition, measurement, presentation and disclosure in the financial statements of tax positions taken or expected to be taken on a tax return, including the decision whether to file or not file in a particular jurisdiction. FIN No. 48 is effective for fiscal years beginning after December 15, 2006. We will adopt FIN No. 48 beginning in the first quarter of fiscal 2008. We are currently evaluating the impact, if any, the adoption of FIN No. 48 will have on our operating income or net earnings. The cumulative effect, if any, of applying the provisions of FIN No. 48 will be reported as an adjustment to retained earnings as of the beginning of fiscal 2008.

In September 2006, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin (SAB) No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*, which provides interpretive guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment. SAB No. 108 is effective for fiscal years ending after November 15, 2006. Early application is encouraged, but not required. We are required to adopt SAB No. 108 for our fiscal year ending March 3, 2007. We are currently assessing the impact, if any, the adoption of SAB No. 108 will have on our operating income or net earnings. The cumulative effect, if any, of applying the provisions of SAB No. 108 will be reported as an adjustment to beginning-of-year retained earnings.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, the FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this Statement does not require any new fair value measurements. SFAS No. 157 is effective for fiscal years beginning after December 15, 2007. We plan to adopt SFAS No. 157 beginning in the first quarter of fiscal 2009. We are currently evaluating the impact, if any, the adoption of SFAS No. 157 will have on our operating income or net earnings.

15. Condensed Consolidating Financial Information:

Our convertible debentures, due in 2022, are guaranteed by our wholly owned indirect subsidiary Best Buy Stores, L.P. Investments in subsidiaries of Best Buy Stores, L.P., which have not guaranteed the convertible debentures, are accounted for under the equity method. Certain prior-year amounts were reclassified as described in Note 1, *Basis of Presentation*, in this Quarterly Report on Form 10-Q. The aggregate principal balance and carrying amount of our convertible debentures is $402 million.

The debentures may be converted into shares of our common stock if certain criteria are met as described in Note 4, *Debt*, of the Notes to Consolidated Financial Statements in our Annual Report on Form 10-K for the fiscal year ended February 25, 2006. During a portion of the six months ended August 26, 2006, our closing stock price exceeded the specified stock price for more than 20 trading days in a 30-trading-day period. Therefore, debenture holders had the option to convert their debentures into shares of our common stock. However, no debentures were so converted. Due to changes in the price of our common stock, the debentures were no longer convertible as of August 26, 2006, and through October 5, 2006.

We file a consolidated U.S. federal income tax return. Income taxes are allocated in accordance with our tax allocation agreement. U.S. affiliates receive no tax benefit for taxable losses, but are allocated taxes at the required effective income tax rate if they have taxable income.

The following tables present condensed consolidating balance sheets as of August 26, 2006; February 25, 2006; and August 27, 2005; condensed consolidating statements of earnings for the three and six months ended August 26, 2006, and August 27, 2005; and condensed consolidating statements of cash flows for the six months ended August 26, 2006, and August 27, 2005:

Condensed Consolidating Balance Sheets
As of August 26, 2006
(Unaudited)
$ in millions

	Best Buy Co., Inc.	Guarantor Subsidiary	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Assets					
Current Assets					
Cash and cash equivalents	$ 181	$ 67	$ 856	$	$ 1,104
Short-term investments	1,527		37		1,564
Receivables	19	336	128		483
Merchandise inventories		3,355	935	(241)	4,049
Other current assets	18	135	556	(22)	687
Intercompany receivable			3,710	(3,710)	
Intercompany note receivable	500			(500)	
Total current assets	2,245	3,893	6,222	(4,473)	7,887
Net Property and Equipment	241	1,786	763	(3)	2,787
Goodwill		6	1,004		1,010
Other Intangible Assets			83		83
Long-Term Investments	277				277
Other Assets	99	260	158	(154)	363
Investments in Subsidiaries	5,240	163	1,335	(6,738)	
Total Assets	$ 8,102	$ 6,108	$ 9,565	$ (11,368)	$ 12,407
Liabilities and Shareholders Equity					
Current Liabilities					
Accounts payable	$	$	$ 3,858	$	$ 3,858
Unredeemed gift card liabilities		358	34		392
Accrued compensation and related expenses		164	99		263
Accrued liabilities	8	457	512	(19)	958
Accrued income taxes	394	5			399
Current portion of long-term debt	404	10	82		496
Intercompany payable	1,348	2,362		(3,710)	
Intercompany note payable		500		(500)	
Total current liabilities	2,154	3,856	4,585	(4,229)	6,366
Long-Term Liabilities	235	795	47	(685)	392
Long-Term Debt	6	122	56		184
Minority Interests			31		31
Shareholders Equity	5,707	1,335	4,846	(6,454)	5,434
Total Liabilities and Shareholders Equity	$ 8,102	$ 6,108	$ 9,565	$ (11,368)	$ 12,407

Condensed Consolidating Balance Sheets
As of February 25, 2006
(Unaudited)
$ in millions

	Best Buy Co., Inc.	Guarantor Subsidiary	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Assets					
Current Assets					
Cash and cash equivalents	$ 10	$ 79	$ 659	$	$ 748
Short-term investments	2,884		167		3,051
Receivables	27	319	93		439
Merchandise inventories		3,173	636	(471)	3,338
Other current assets	20	211	265	(87)	409
Intercompany receivable			3,757	(3,757)	
Intercompany note receivable	500			(500)	
Total current assets	3,441	3,782	5,577	(4,815)	7,985
Net Property and Equipment	244	1,733	737	(2)	2,712
Goodwill		6	551		557
Other Intangible Assets			44		44
Long-Term Investments	218				218
Other Assets	108	266	131	(157)	348
Investments in Subsidiaries	4,813		1,124	(5,937)	
Total Assets	$ 8,824	$ 5,787	$ 8,164	$ (10,911)	$ 11,864
Liabilities and Shareholders Equity					
Current Liabilities					
Accounts payable	$	$	$ 3,234	$	$ 3,234
Unredeemed gift card liabilities		430	39		469
Accrued compensation and related expenses	3	225	126		354
Accrued liabilities	7	518	392	(39)	878
Accrued income taxes	670		76	(43)	703
Current portion of long-term debt	404	9	5		418
Intercompany payable	1,717	2,134		(3,851)	
Intercompany note payable		500		(500)	
Total current liabilities	2,801	3,816	3,872	(4,433)	6,056
Long-Term Liabilities	257	732	31	(647)	373
Long-Term Debt	7	115	56		178
Shareholders Equity	5,759	1,124	4,205	(5,831)	5,257
Total Liabilities and Shareholders Equity	$ 8,824	$ 5,787	$ 8,164	$ (10,911)	$ 11,864

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Condensed Consolidating Balance Sheets
As of August 27, 2005
(Unaudited)
$ in millions

	Best Buy Co., Inc.	Guarantor Subsidiary	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Assets					
Current Assets					
Cash and cash equivalents	$ 106	$ 69	$ 439	$	$ 614
Short-term investments	2,071		140		2,211
Receivables	18	319	52		389
Merchandise inventories		2,876	624	(250)	3,250
Other current assets	20	137	265	(44)	378
Intercompany receivable			2,696	(2,696)	
Intercompany note receivable	500			(500)	
Total current assets	2,715	3,401	4,216	(3,490)	6,842
Net Property and Equipment	247	1,581	698	(3)	2,523
Goodwill		3	526		529
Other Intangible Assets			42		42
Long-Term Investments	122				122
Other Assets	120	163	92	(174)	201
Investments in Subsidiaries	3,762		1,133	(4,895)	
Total Assets	$ 6,966	$ 5,148	$ 6,707	$ (8,562)	$ 10,259
Liabilities and Shareholders Equity					
Current Liabilities					
Accounts payable	$	$	$ 2,760	$	$ 2,760
Unredeemed gift card liabilities		342	16		358
Accrued compensation and related expenses	1	147	68		216
Accrued liabilities	9	500	430	(23)	916
Accrued income taxes	206		69	(21)	254
Current portion of long-term debt	2	6	4		12
Intercompany payable	1,001	1,728		(2,729)	
Intercompany note payable		500		(500)	
Total current liabilities	1,219	3,223	3,347	(3,273)	4,516
Long-Term Liabilities	239	711	60	(630)	380
Long-Term Debt	410	81	49		540
Shareholders Equity	5,098	1,133	3,251	(4,659)	4,823
Total Liabilities and Shareholders Equity	$ 6,966	$ 5,148	$ 6,707	$ (8,562)	$ 10,259

Condensed Consolidating Statements of Earnings

For the Three Months Ended August 26, 2006
(Unaudited)
$ in millions

	Best Buy Co., Inc.	Guarantor Subsidiary	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Revenue	$ 5	$ 6,254	$ 6,878	$ (5,534)	$ 7,603
Cost of goods sold		5,099	6,215	(5,613)	5,701
Gross profit	5	1,155	663	79	1,902
Selling, general and administrative expenses	37	1,097	442	(4)	1,572
Operating (loss) income	(32)	58	221	83	330
Net interest income (expense)	19	(5)	7		21
Equity in earnings (loss) of subsidiaries	204	(6)	27	(225)	
Earnings before income tax expense and minority interests	191	47	255	(142)	351
Income tax expense	23	20	78		121
Minority interests					
Net earnings	$ 168	$ 27	$ 177	$ (142)	$ 230

Condensed Consolidating Statements of Earnings
For the Six Months Ended August 26, 2006
(Unaudited)
$ in millions

	Best Buy Co., Inc.	Guarantor Subsidiary	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Revenue	$ 9	$ 12,082	$ 13,230	$ (10,759)	$ 14,562
Cost of goods sold		9,906	12,018	(11,029)	10,895
Gross profit	9	2,176	1,212	270	3,667
Selling, general and administrative expenses	89	2,070	851	(10)	3,000
Operating (loss) income	(80)	106	361	280	667
Net interest income (expense)	44	(9)	9		44
Equity in earnings (loss) of subsidiaries	357	(5)	56	(408)	
Earnings before income tax expense and minority interests	321	92	426	(128)	711
Income tax expense	86	36	125		247
Minority interests					
Net earnings	$ 235	$ 56	$ 301	$ (128)	$ 464

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Condensed Consolidating Statements of Earnings

For the Three Months Ended August 27, 2005
(Unaudited)
$ in millions

	Best Buy Co., Inc.	Guarantor Subsidiary	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Revenue	$ 5	$ 5,802	$ 6,732	$ (5,837)	$ 6,702
Cost of goods sold		4,659	6,031	(5,699)	4,991
Gross profit	5	1,143	701	(138)	1,711
Selling, general and administrative expenses	7	1,092	391	(40)	1,450
Operating (loss) income	(2)	51	310	(98)	261
Net interest income (expense)	20	(4)	2		18
Equity in earnings (loss) of subsidiaries	266	(10)	21	(277)	
Earnings before income tax expense	284	37	333	(375)	279
Income tax (benefit) expense	(15)	17	89		91
Net earnings	$ 299	$ 20	$ 244	$ (375)	$ 188

Condensed Consolidating Statements of Earnings

For the Six Months Ended August 27, 2005
(Unaudited)
$ in millions

	Best Buy Co., Inc.	Guarantor Subsidiary	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Revenue	$ 9	$ 11,140	$ 12,264	$ (10,593)	$ 12,820
Cost of goods sold		8,966	11,201	(10,616)	9,551
Gross profit	9	2,174	1,063	23	3,269
Selling, general and administrative expenses	15	2,073	757	(76)	2,769
Operating (loss) income	(6)	101	306	99	500
Net interest income (expense)	36	(9)	4		31
Equity in earnings (loss) of subsidiaries	284	(22)	39	(301)	
Earnings before income tax expense	314	70	349	(202)	531
Income tax expense	37	32	104		173
Net earnings	$ 277	$ 38	$ 245	$ (202)	$ 358

Condensed Consolidating Statements of Cash Flows
For the Six Months Ended August 26, 2006
(Unaudited)
$ in millions

	Best Buy Co., Inc.	Guarantor Subsidiary	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Total cash (used in) provided by operating activities	$ (353)	$ (46)	$ 368	$	$ (31)
Investing activities					
Additions to property and equipment		(222)	(77)		(299)
Acquisition of businesses, net of cash acquired			(421)		(421)
Purchases of available-for-sale securities	(1,503)		(132)		(1,635)
Sales of available-for-sale securities	2,798		262		3,060
Changes in restricted assets			(16)		(16)
Other, net		6	6		12
Total cash provided by (used in) investing activities	1,295	(216)	(378)		701
Financing activities					
Repurchase of common stock	(462)				(462)
Issuance of common stock under employee stock purchase plan and for the exercise of stock options	117				117
Dividends paid	(78)				(78)
Long-term debt payments	(1)		(6)		(7)
Proceeds from issuance of long-term debt		22	16		38
Excess tax benefits from stock-based compensation	22				22
Other, net			37		37
Change in intercompany receivable/payable	(369)	228	141		
Total cash (used in) provided by financing activities	(771)	250	188		(333)
Effect of exchange rate changes on cash			19		19
Increase (decrease) in cash and cash equivalents	171	(12)	197		356
Cash and cash equivalents at beginning of period	10	79	659		748
Cash and cash equivalents at end of period	$ 181	$ 67	$ 856	$	$ 1,104

Condensed Consolidating Statements of Cash Flows
For the Six Months Ended August 27, 2005
(Unaudited)
$ in millions

	Best Buy Co., Inc.	Guarantor Subsidiary	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Total cash (used in) provided by operating activities	$ (237)	$ (29)	$ 69	$	$ (197)
Investing activities					
Additions to property and equipment		(182)	(98)		(280)
Purchases of available-for-sale securities	(964)		(31)		(995)
Sales of available-for-sale securities	1,805				1,805
Proceeds from property dispositions	14		28		42
Changes in restricted assets			12		12
Other, net	4	6			10
Total cash provided by (used in) investing activities	859	(176)	(89)		594
Financing activities					
Repurchase of common stock	(262)				(262)
Issuance of common stock under employee stock purchase plan and for the exercise of stock options	187				187
Dividends paid	(73)				(73)
Long-term debt payments	(7)	(59)			(66)
Proceeds from issuance of long-term debt		3	4		7
Excess tax benefits from stock-based compensation	21				21
Other, net	(1)		38		37
Change in intercompany receivable/payable	(440)	268	172		
Total cash (used in) provided by financing activities	(575)	212	214		(149)
Effect of exchange rate changes on cash			12		12
Increase in cash and cash equivalents	47	7	206		260
Cash and cash equivalents at beginning of period	59	62	233		354
Cash and cash equivalents at end of period	$ 106	$ 69	$ 439	$	$ 614

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Management s Discussion and Analysis of Financial Condition and Results of Operations (MD&A) is designed to provide a reader of our financial statements with a narrative from the perspective of our management on our financial condition, results of operations, liquidity and certain other factors that may affect our future results. Our MD&A is presented in seven sections:

- Overview
- Results of Operations
- Liquidity and Capital Resources
- Off-Balance-Sheet Arrangements and Contractual Obligations
- Significant Accounting Policies and Estimates
- New Accounting Standards
- Outlook

We believe it is useful to read our MD&A in conjunction with our Annual Report on Form 10-K for the fiscal year ended February 25, 2006, as well as our reports on Forms 10-Q and 8-K and other publicly available information.

Overview

Best Buy Co., Inc. is a specialty retailer of consumer electronics, home-office products, entertainment software, appliances and related services. We operate two reportable segments: Domestic and International. The Domestic segment is comprised of all U.S. store and online operations, including Best Buy, Geek Squad, Pacific Sales Kitchen and Bath Centers (Pacific Sales) and Magnolia Audio Video. The International segment is comprised of all Canadian store and online operations, including Future Shop, Best Buy and Geek Squad, as well as our Jiangsu Five Star Appliance Co., Ltd. (Five Star) store and online operations in China. For additional information regarding our business segments, see Note 8, *Segments*, of the Notes to Consolidated Condensed Financial Statements in this Quarterly Report on Form 10-Q.

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.

Acquisitions

Pacific Sales Kitchen & Bath Centers, Inc.

On March 7, 2006, we acquired all of the common stock of 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 affluent 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 rapidly growing high-end segment of the U.S. appliance market. Pacific Sales, which recorded calendar 2005 revenue of approximately $325 million, is expected to be nominally accretive to net earnings for fiscal 2007. As of August 26, 2006, Pacific Sales operated 14 showrooms in Southern California. For the second quarter and first six months of fiscal 2007, Pacific Sales contributed revenue of $78 million and $142 million, respectively, to our consolidated financial results.

Jiangsu Five Star Appliance Co., Ltd.

On June 8, 2006, we acquired a 75% interest in Five Star for $184 million, including a working capital injection of $122 million and transaction costs. Five Star is one of China s largest appliance and consumer electronics retailers, with calendar 2005 revenue of nearly $700 million. We made the investment in Five Star to further our international growth plans, increase our knowledge of Chinese customers and obtain an immediate retail presence in China. Five

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Star, which is expected to be neutral to net earnings for fiscal 2007, employs a business model that carries a significantly lower gross profit rate and a significantly lower selling, general and administrative expenses (SG&A) rate than our other operations. Consistent with China s statutory requirements, Five Star s fiscal year ends on December 31. Therefore, we have decided to consolidate Five Star s financial results on a two-month lag. As of August 26, 2006, Five Star operated 131 stores located in eight of China s 34 provinces. Five Star s operations for the period of June 8, 2006, through June 30, 2006, contributed revenue of $80 million to our consolidated financial results for both the second quarter and first six months of fiscal 2007.

Financial Reporting Changes

To maintain consistency and comparability, we reclassified certain prior-year amounts to conform to the current year presentation as described in Note 1, *Summary of Significant Accounting Policies*, of the Notes to Consolidated Financial Statements in our Annual Report on Form 10-K for the fiscal year ended February 25, 2006. In addition, to be consistent with our accounting policies, we reclassified selected balances from receivables to cash and cash equivalents in our February 25, 2006, consolidated condensed balance sheet. These reclassifications had no effect on previously reported operating income, net earnings or shareholders equity.

Highlights

- Net earnings for the second quarter of fiscal 2007 were $230 million, or $0.47 per diluted share, compared with $188 million, or $0.37 per diluted share, for the same period one year ago.

- Revenue for the second quarter of fiscal 2007 increased 13% to $7.6 billion, compared with $6.7 billion for the same period one year ago, driven primarily by the addition of new stores in the past 12 months and a 3.7% comparable store sales gain.

- Our gross profit rate for the second quarter of fiscal 2007 decreased to 25.0% of revenue, compared with 25.5% of revenue for the same period one year ago. The decrease was due primarily to increased competition in the entertainment software and home-office product groups.

- Our SG&A rate for the second quarter of fiscal 2007 decreased to 20.7% of revenue, compared with 21.6% of revenue for the same period one year ago. The decrease was due primarily to a short-term reduction in advertising spending, productivity gains, the leveraging effect of the 13% growth in revenue and our expense reduction efforts, which included reduced consulting and travel costs.

- Our effective income tax rate increased to 34.6% for the current quarter compared with 32.7% for the same period one year ago.

- On June 8, 2006, we acquired a 75% interest in Five Star, one of China s largest appliance and consumer electronics retailers. The total purchase price was $184 million, including a working capital injection of $122 million and transaction costs. The inclusion of Five Star s financial results reduced both our gross profit rate and our SG&A rate for the second quarter of fiscal 2007 by approximately 0.1% of revenue.

- On June 21, 2006, we announced that our Board of Directors had authorized a new $1.5 billion share repurchase program, and also announced the intention to increase our quarterly cash dividend on our common stock by 25% to $0.10 per common share effective with the dividend payable in October 2006.

- During the second quarter of fiscal 2007, we repurchased approximately 4.7 million shares of our common stock at an average price of $48.15 per share, or $224 million in the aggregate.

- We are encouraged by our results for the first six months of fiscal 2007. We continue to project net earnings for fiscal 2007 in the range of $2.65 to $2.80 per diluted share.

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Results of Operations

Consolidated Performance Summary

The following table presents unaudited selected consolidated financial data ($ in millions, except per share amounts):

	Three Months Ended August 26, 2006	August 27, 2005	Six Months Ended August 26, 2006	August 27, 2005
Revenue	$ 7,603	$ 6,702	$ 14,562	$ 12,820
Revenue % change	13 %	10 %	14 %	11 %
Comparable store sales % gain(1)	3.7 %	3.5 %	4.2 %	3.9 %
Gross profit as % of revenue	25.0 %	25.5 %	25.2 %	25.5 %
SG&A as % of revenue	20.7 %	21.6 %	20.6 %	21.6 %
Operating income	$ 330	$ 261	$ 667	$ 500
Operating income as % of revenue	4.3 %	3.9 %	4.6 %	3.9 %
Net earnings	$ 230	$ 188	$ 464	$ 358
Diluted earnings per share	$ 0.47	$ 0.37	$ 0.94	$ 0.71

(1) Comprised of revenue at stores and Web 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 the acquisition. The calculation of the comparable store sales percentage gain excludes the effect of fluctuations in foreign currency exchange rates. The method of calculating comparable store sales varies across the retail industry. As a result, our calculation of comparable store sales may not be the same as certain other retailers.

Net earnings were $230 million, or $0.47 per diluted share, for the second quarter of fiscal 2007, compared with $188 million, or $0.37 per diluted share, for the same period one year ago. For the first six months of fiscal 2007, net earnings were $464 million, or $0.94 per diluted share, compared with $358 million, or $0.71 per diluted share, for the same period one year ago. For both the second quarter and first six months of fiscal 2007, the increase in net earnings reflected an increase in revenue, including the addition of new stores in the past 12 months and a comparable store sales gain, and a reduction in our SG&A rate. These factors were partially offset by a decline in our gross profit rate and a higher effective income tax rate. Net earnings for the first six months of fiscal 2007 also benefited from net interest income of $44 million, compared with $31 million for the same period of the prior fiscal year.

Revenue for the second quarter of fiscal 2007 increased 13% to $7.6 billion, compared with $6.7 billion for the same period one year ago. For the first six months of fiscal 2007, revenue increased 14% to $14.6 billion, compared with $12.8 billion for the same period one year ago. The addition of new Best Buy and Future Shop stores in the past 12 months accounted for nearly one-half of the revenue increase for both the fiscal second quarter and six-month period. The comparable store sales gain accounted for approximately three-tenths of the revenue increase for both the fiscal second quarter and six-month period. Revenue generated by Five Star and Pacific Sales accounted for approximately one-fifth of the revenue increase for the fiscal second quarter and approximately one-tenth of the revenue increase for the six-month period. The remainder of the increase in revenue for the fiscal second quarter and first six months was due to the favorable effect of fluctuations in foreign currency exchange rates. Based on our quarterly weighted-average calculation, the value of the Canadian dollar increased 9% to $0.89 per U.S. dollar for the quarter ended August 26, 2006, up from $0.82 per U.S. dollar for the quarter ended August 27, 2005.

Revenue mix and comparable store sales percentage changes by product group for the second quarter of fiscal 2007 were as follows:

	Revenue Mix Summary Three Months Ended August 26, 2006		August 27, 2005		Comparable Store Sales Summary Three Months Ended August 26, 2006		August 27, 2005	
Consumer Electronics	44	%	41	%	8.9	%	11.4	%
Home-Office	33	%	36	%	0.0	%	(0.7	)%
Entertainment Software	15	%	16	%	0.8	%	(7.2	)%
Appliances	8	%	7	%	(2.6	)%	10.9	%
Total	100	%	100	%	3.7	%	3.5	%

Our comparable store sales for the second quarter of fiscal 2007 increased 3.7%, reflecting a higher average transaction amount driven by the continued growth in sales of higher-ticket items, including flat-panel televisions and notebook computers. In addition, comparable store sales were driven by continued consumer demand for and the increased affordability of these products as strong unit volume growth was somewhat muted by declines in average selling prices. Also contributing to the fiscal second-quarter comparable store sales gain was an increase in online purchases, as we continue to add features and capabilities to our Web sites. Products and services having the largest effect on our fiscal second quarter comparable store sales gain included flat-panel televisions, notebook computers, video gaming and computer services. These strong-selling product and services categories more than offset comparable store sales declines in product categories such as tube and projection televisions, CDs, desktop computers and printers.

Our gross profit rate for the second quarter of fiscal 2007 decreased by 0.5% of revenue to 25.0% of revenue, with our Domestic and International segments gross profit rates decreasing by 0.3% of revenue and 1.8% of revenue, respectively. For the first six months of fiscal 2007, our gross profit rate decreased by 0.3% of revenue to 25.2% of revenue. The decline in our gross profit rate for both the fiscal second quarter and first six months was due primarily to increased competition in the entertainment software and home-office product groups. The decrease was partially offset by benefits from a higher-margin revenue mix, including the continued growth in our higher-margin computer services business. The acquisition of Five Star, which carries a significantly lower gross profit rate than our other operations, also contributed to the decrease, reducing our gross profit rate for the second quarter of fiscal 2007 by approximately 0.1% of revenue.

Our SG&A rate for the second quarter of fiscal 2007 decreased by 0.9% of revenue to 20.7% of revenue. For the first six months of fiscal 2007, our SG&A rate decreased by 1.0% of revenue to 20.6% of revenue. The decrease in our SG&A rate for both the fiscal second quarter and first six months was due primarily to a short-term reduction in advertising spending, productivity gains, the leveraging effect of the growth in revenue and our expense reduction efforts, which included reduced consulting and travel costs. The decrease in our SG&A rate for the first six months of fiscal 2007 was partially offset by expenses related to severance and reorganization, which increased our SG&A rate by approximately 0.2% of revenue ($0.04 per diluted share).

Net Interest Income

Net interest income for the second quarter and first six months of fiscal 2007 increased to $21 million and $44 million, respectively, compared with net interest income of $18 million and $31 million, respectively, for the second quarter and first six months of fiscal 2006. The increase in net interest income was due primarily to higher investment yields, partially offset by a lower average cash and investment balance.

Effective Income Tax Rate

Our effective income tax rate for the second quarter and first six months of fiscal 2007 was 34.6% and 34.8%, respectively, up from 32.7% and 32.6%, respectively, for the corresponding periods of fiscal 2006. The increase was due primarily to the absence of the favorable resolution of certain income tax matters recognized in the comparable periods of fiscal 2006.

Segment Performance Summary

Domestic

The following table presents unaudited selected financial data for the Domestic segment ($ in millions):

	Three Months Ended August 26, 2006	August 27, 2005	Six Months Ended August 26, 2006	August 27, 2005
Revenue	$ 6,621	$ 5,997	$ 12,783	$ 11,489
Revenue % change	10 %	9 %	11 %	10 %
Comparable stores sales % gain(1)	3.0 %	3.8 %	3.8 %	4.1 %