Circuit City

The objectives of this case are to improve your understanding of capital structure issues and off balance sheet financing, with an improvement in mastery of cash flow analytics and distortions.

Barry M Frohlinger

Circuit City Stores financial statements are attached. In addition, find financial information on Best Buy, Circuit City's largest competitor. [We will use the competitor information later for analysis]. You should be aware that Circuit City has a credit card operation, managed by its wholly-owned captive bank while Best Buy does not operate a credit card operation.

You will use this case to improve your understanding of capital structure issues and off balance sheet financing.

A] Comment on the equity structure change of the Company as of January 24, 1997.

B] Identify the amount of off-balance sheet financing for the Company.

C] Comment on Circuit City's capital structure decision [including debt, equity, securitization and leasing] versus Best Buy.

D] Identify the distortions to Cash Flow from Operations due to off-balance sheet financing.

E] Build a simple EXCEL model with VLOOKUP to run a synthetic debt rating for Interest Coverage [EBIT/Interest] and Leverage [Debt/Debt + Minority Interest + Equity]

Circuit City Stores, Inc. was incorporated in 1949. Its retail operations consist of Circuit City Superstores, Circuit City electronics-only stores and mall-based Circuit City Express stores. Certain of Circuit City Stores, Inc. subsidiaries operate CarMax Auto Superstores, a used-and new-car retail business. In addition, as of February 28, 1999, Circuit City Stores, Inc. owned approximately 75 percent of Digital Video Express. The Company has been allocated 100 percent of the losses since inception. Digital Video Express primarily is engaged in the business of replicating and distributing specially encrypted DVD discs at wholesale. The Company has wholly owned finance operations that provide consumer revolving credit and automobile installment loans.

Changes in Capital Structure. On January 24, 1997, shareholders of Circuit City Stores, Inc. and subsidiaries approved the creation of two common stock series. The Company's existing common stock was subsequently redesignated as Circuit City Stores, Inc.-Circuit City Group Common Stock. In an initial public offering, which was completed February 7, 1997, the Company sold 21.86 million shares of Circuit City Stores, Inc.-CarMax Group Common Stock.

The Circuit City Group Common Stock is intended to track the performance of the Circuit City store-related operations, the Company's investment in Digital Video Express and the Group's retained interest in the CarMax Group. The CarMax Group Common Stock is intended to track the performance of the CarMax operations.

Notwithstanding the attribution of the Company's assets and liabilities (including contingent liabilities) and stockholders' equity between the Circuit City Group and the CarMax Group for the purposes of preparing their respective financial statements, holders of Circuit City Group Common Stock and holders of CarMax Group Common Stock are shareholders of the Company and continue to be subject to all of the risks associated with an investment in the Company and all of its businesses, assets and liabilities. Such attribution and the change in the equity structure of the Company does not affect title to the assets or responsibility for the liabilities of the Company or any of its subsidiaries. The results of operations or financial condition of one Group could affect the results of operations or financial condition of the other Group. Accordingly, the Company's consolidated financial statements should be read in conjunction with the financial statements of each Group.

The following terms and definitions are used:

The Company refers to Circuit City Stores, Inc. and subsidiaries, which includes Circuit City retail stores and related operations, the CarMax retail stores and related operations, and the Company's investment in Digital Video Express.

Circuit City refers to the retail operations bearing the Circuit City name and to all related operations such as product service and its finance operation.

Circuit City Group refers to the Circuit City operations, the Company's investment in Digital Video Express and the retained interest in the CarMax Group.

CarMax Group and CarMax refer to retail locations bearing the CarMax name and to all related operations such as its finance operation.

Circuit City Group:

General. Circuit City is a leading national retailer of brand-name consumer electronics, personal computers, major appliances and entertainment software. It sells video equipment, including televisions, digital satellite systems, video cassette recorders, camcorders and digital video disc players; audio equipment, including home stereo systems, compact disc players, tape recorders and tape players; mobile electronics, including car stereo systems and security systems; home office products, including personal computers, printers, peripherals, software and facsimile machines; other consumer electronics products, including cellular phones, telephones and portable audio and video products; major appliances, including washers, dryers, refrigerators, microwave ovens and ranges; and entertainment software.

Each Circuit City store location follows detailed operating procedures and merchandising programs. Included are procedures for inventory maintenance, advertising, customer relations, store administration, merchandise display, store security and the demonstration and sale of products. Merchandise lines vary from location to location based on store size and market characteristics. Most merchandise is supplied directly to the stores by regional warehouse distribution facilities.

Expansion. As of April 30, 1999, Circuit City operated 590 retail locations throughout the United States. Circuit City has established its presence in virtually all of the nation's top 100 markets and will continue adding to the existing store base as attractive market opportunities arise. In fiscal 2000, Circuit City expects to open approximately 35 additional Superstores and remodel another 50 to include its most recent merchandising innovations. Management estimates that it has the opportunity to open approximately 250 additional stores. Circuit City's goal is to maximize profitability in each market it serves by capturing large market shares that produce high sales volumes across a broad merchandise mix.

Merchandising. Because management believes that local markets have individual characteristics which vary greatly by the advertising, merchandising and pricing strategies of competitors, Circuit City has organized its marketing function to focus on markets with similar competitive conditions. Circuit City's operating regions benefit from a centralized buying organization. The central buying staff reduces costs by purchasing in large volumes, structures a sound basic merchandising program and is supported by advanced management information and distribution systems.

Circuit City's merchandising strategy emphasizes a broad selection of products, including the industry's newest technologies, and a wide range of prices. Merchandise mix and displays are controlled centrally to help ensure a high level of consistency from store to store. Merchandise pricing and selling strategies vary by market to reflect competitive conditions.

Although suggested retail prices are established by the corporate merchandising department, each store manager is responsible for shopping the local competition on a regular basis and is empowered to adjust retail prices to meet in-market conditions. As part of its competitive strategy, Circuit City advertises low prices and provides customers with a low-price guarantee. Circuit City will beat any price from a local store stocking the same new item, available for sale with a manufacturer's warranty and in a factory-sealed box. In most cases, if a customer finds a lower price, including Circuit City's own

sale price, within 30 days, Circuit City will refund 110 percent of the difference to the customer.

Suppliers. During fiscal 1999, Circuit City's 10 largest suppliers accounted for approximately 55 percent of merchandise purchased. Circuit City's major suppliers include Sony Electronics, Thomson, Panasonic, Whirlpool, Compaq, JVC, Packard Bell, Hewlett Packard, IBM, and Maytag. Brand-name advertised products are sold by all of Circuit City's retail locations. Circuit City has no significant long-term contracts for the purchase of merchandise.

In the past, Circuit City has not experienced any continued or ongoing difficulty obtaining satisfactory sources of supply and believes that adequate sources of supply exist for the types of merchandise sold in its stores.

Advertising. The Circuit City Group relies on considerable amounts of advertising to maintain high levels of consumer awareness. Advertising expenditures were 4.5 percent of sales in fiscal 1999, 4.6 percent of sales in fiscal 1998 and 4.8 percent of sales in fiscal 1997. Circuit City is generally one of the largest newspaper advertisers in the markets that it serves. Circuit City primarily uses print advertising, including multi-page vehicles and run-of-press newspaper ads, for Superstore and electronics-only store advertising. Circuit City emphasizes the use of multi-page vehicles to allow a more extensive presentation of the broad selection of products and price ranges it carries. These multi-page vehicles are generally distributed in newspapers. Circuit City advertisements are regularly seen in USA Today and on top-rated sports and entertainment programs.

Competition. From mid-fiscal 1996 through fiscal 1998, a lack of significant product introductions resulted in lower average retail prices and weak sales throughout the industry. This industry weakness resulted in a highly competitive climate, and a significant number of regional competitors closed stores. In fiscal 1999, the industry began to emerge from this period of declining sales. Despite the improvement, the consumer electronics industry remains highly competitive. Circuit City's primary competitors are large specialty, discount or warehouse retailers with generally lower levels of service.

Circuit City uses selection, service and pricing to differentiate itself from the competition. As part of its competitive strategy, Circuit City Superstores offer a broad selection of top-quality merchandise that includes 3,200 to 4,000 brand-name items (excluding entertainment software), depending on the selling square footage of the Superstore. Professionally trained sales counselors, convenient credit options, factory-authorized product repair, home delivery, installation centers for automotive electronics, exchange and no-lemon policies, reflect a strong commitment to customer service. Circuit City strives to maintain highly competitive prices and offers customers the low-price guarantee previously described.

Customer Satisfaction. Extensive market research is conducted to measure Circuit City's customer service record and to refine its consumer offer. Over 375,000 customer surveys were conducted last year to track satisfaction among Circuit City's existing customers. These surveys, conducted from customer transaction records, measure satisfaction with all points of interaction, including sales counselors, cashiers, warehouse staff, Roadshop installers, home delivery personnel and product service specialists. Quick feedback enables management to identify issues that need to be addressed, ensuring that store and individual performance remain focused on providing the highest possible level of customer service.

Training. Circuit City staffs its Superstores with commissioned sales counselors, support personnel (cashiers and stockpersons), a store manager, one or more sales managers and an operations manager. New sales counselors complete an in-market training program focused on product knowledge, customer service and store operations. These programs also provide experienced Associates with ongoing training in new technologies and merchandising opportunities. In addition, every month sales counselors are required to test their knowledge of important products through Training Tracker, an online test administration program. Market training facilities are utilized for classroom sessions taught by professional trainers, and a state-of-the-art, in-house video studio produces video-based training materials. Formalized training for store, sales and operations managers focuses on human resource management, sales management and critical operating procedures. Individual development plans address personal training needs, giving Associates advancement opportunity.

Consumer Credit. Because consumer electronics, personal computers and major appliances represent relatively large purchases for the average consumer, Circuit City's business is affected by consumer credit availability, which varies with the state of the economy and the location of a particular store. In fiscal 1999, approximately 15 percent of Circuit City's total sales were made through its private-label credit card and 45 percent through third-party credit sources.

In fiscal 1991, the Company established a credit card finance operation to issue its private-label credit card. The credit card finance operation is located in Kennesaw, Ga. This credit program enhances customer service with increased credit availability, on-line links between the stores and the credit operation and better control over customer interactions. Interfacing the finance operation with Circuit City's point-of-sale (POS) system has produced a rapid customer credit approval process. A customer's application can be electronically scored, and qualified customers can generally receive approval in under one minute. In addition to increased credit availability, the private-label credit card program provides Circuit City with additional marketing opportunities, including direct mail campaigns to credit card customers and special financing programs for promotions. The finance operation's credit extension, customer service and collection operations are fully automated with state-of-the-art technology to maintain a high level of profitability and customer service. This technology aids its collection philosophy of contacting cardholders in the preliminary days of delinquency to resolve any past due status.

The credit card finance operation also manages a bankcard portfolio. Receivables generated by both the private-label credit card and bankcard programs are sold to non-affiliated entities under asset securitization programs.

Systems. Circuit City's in-store POS system maintains an on-line record of all transactions and allows management to track performance by region, store and individual sales counselor. The information gathered by the system supports automatic replenishment of in-store inventory from the regional distribution centers and is incorporated into product buying decisions. The POS system is interfaced with the finance operation's credit approval system. In the stores, electronic signature capture for all credit card purchases, bar-code scanning for product returns and repairs, automatic price tag printing for price

changes and computerized home delivery scheduling enhance Circuit City's customer service, eliminating time-consuming administrative tasks for store Associates and reducing costs through smoother store-level execution.

Circuit City's Customer Service Information System maintains an on-line history of customer purchases and enables sales counselors to better assist customers with purchases by ensuring that new products can be integrated with existing products in the home. This system also facilitates product returns and product repair.

Distribution. At April 30, 1999, Circuit City operated nine automated electronics distribution centers. These centers are designed to serve stores within a 500-mile range. They utilize conveyor systems and laser bar-code scanners to reduce labor requirements, prevent inventory damage and maintain inventory control. Circuit City also operates smaller distribution centers handling primarily appliances and larger electronics products. Management believes that the use of the distribution centers enables it to efficiently distribute a broad selection of merchandise to its stores, reduce inventory requirements at individual stores, benefit from volume purchasing and maintain accounting control. Circuit City also operates an automated, centralized distribution center for entertainment software. Most of Circuit City's store merchandise is distributed through its distribution centers.

Service. Circuit City offers service and repair for nearly all the products it sells. Customers also are able to purchase extended warranty plans on most of the merchandise Circuit City sells.

At April 30, 1999, Circuit City had 38 regional, factory-authorized repair facilities. To meet customer needs, merchandise that requires service or repair usually is moved by truck from the stores to the nearest regional service facility and is returned to the customer at the store after repair. Circuit City also has in-home technicians who service large items not conveniently carried to a store.

Extended warranty plans provide coverage beyond the normal manufacturer's warranty period, usually with terms of coverage (including the manufacturer's warranty period) between 12 and 60 months. Circuit City sells two extended warranty programs on behalf of unrelated third parties that provide these plans for merchandise sold by Circuit City and other retailers. One of these programs is sold in most major markets and features in-home service for personal computer products. The second program covers consumer electronics and major appliances and is also sold in most major markets. In states where third-party warranty sales are not permitted, Circuit City sells its own extended warranty.

Seasonality. Like many retail businesses, the Circuit City Group's sales are greater in the fourth quarter of the fiscal year than in other periods of the fiscal year because of holiday buying patterns. A corresponding pre-seasonal inventory build-up is associated with this sales volume. This increased sales volume results in a lower ratio of fixed costs to sales and a higher ratio of operating income to sales in the fourth fiscal quarter. Circuit City Group's sales for the fourth fiscal quarter (which includes the Christmas season) were $3,029,343,000 in fiscal 1999, $2,585,969,000 in fiscal 1998 and $2,282,625,000 in fiscal 1997. Fourth quarter sales represented approximately 32 percent of total sales in fiscal 1999, 1998 and 1997.

Divx. The Divx system includes DVD players with the Divx feature and Divx discs. Divx offers the consumer a convenient no-return, rental-like system. For a suggested retail price of $4.49, consumers get high-quality digital picture and sound, plus a more convenient, flexible, viewing time than offered by VHS or DVD rental or by pay-per-view. Consumers buy Divx discs whenever it is convenient to shop. Unlike video rentals, the Divx viewing period begins not when consumers leave the store, but when they first insert the disc into their player and push play. After that point, consumers have a 48-hour window in which they can watch the movie as many times as they want. Unlike pay-per-view, the consumer can rewind, scan or pause the movie or even finish watching it the next day. And, in contrast to video rental, the movie never has to be returned, which eliminates all late fees and allows consumers to build an inexpensive home library. Subsequent two-day viewing periods cost only about $3.25, and selected favorite movies can be converted to unlimited viewing for play on any Divx-equipped player registered to their account. On a regular basis, the Divx-equipped player uses the phone connection to automatically transfer viewing information to the Divx billing system. Payment is made through the customer's credit or debit card. This entire process takes place with no customer involvement, and the call never interferes with normal phone usage. No phone connection is ever required during movie play.

After passing key technological tests and securing agreements with consumer electronics manufacturers and major motion picture studios, the Company introduced the Divx concept in September 1997. Digital Video Express has secured agreements with major movie studios to provide titles. At April 30, 1999, approximately 440 titles were available, with up to 40 titles being added each month. The system was launched in two markets in June 1998 with Zenith-Inteq brand players. National roll out began in late September 1998 with the introduction of the RCA brand player. The addition of ProScan and Panasonic players gave Divx four brand selections by early December. JVC, Pioneer, Harman Kardon and Kenwood have announced plans to manufacture DVD players with the Divx feature in fiscal 2000. Divx-equipped players and Divx discs were available in approximately 800 retail stores at the end of fiscal 1999.

In April 1998, Divx opened its Customer Satisfaction Center in Rocky Mount, N.C. This center assists Divx customers with the registration of their players and provides general help and trouble-shooting on any customer issues. In May 1998, Divx opened a distribution center in Jackson, Tenn. That center distributes Divx discs to retailers and directly to customers ordering through DivxFlix, its on-line store at www.divx.com. In January 1999, Divx launched an on-line retail distribution program, called divxwholesale.com for Divx discs. This program allows smaller retailers to quickly and efficiently order new Divx inventory.

In May 1995, the Company agreed to invest $30.0 million in Divx. That commitment was increased to $130.0 million in September 1997. Although that commitment was fulfilled during fiscal 1999, the Company continues to fund the operations of Divx as management continues to explore various financing options. As of February 28, 1999, the Company owned approximately 75 percent of the partnership and has been allocated 100 percent of the losses since inception. The Company allocates its investment in Divx to the Circuit City Group. As of February 28, 1999, the Company had funded approximately $207 million for the operations of Divx.

CarMax Group:

General. In 1993, CarMax pioneered the used-car Superstore concept when it opened its first location in Richmond, Va. In fiscal 1998 and fiscal 1999, CarMax continued the first phase of its national roll out plan. CarMax allows customers to purchase vehicles the same way they can buy virtually every other retail product, with friendly service and non-negotiated low prices. CarMax purchases and sells used vehicles at each of its stores. CarMax reconditions vehicles at most of its stores and sells new vehicles at nine of its locations under sales and service agreements with DaimlerChrysler, Nissan, Mitsubishi, Toyota, Ford, Chevrolet, Cadillac, Subaru and BMW.

Expansion. As of April 30, 1999, CarMax operated 32 store locations, including 29 used-car superstores and 17 new-car franchises. In fiscal 1999, CarMax began testing a hub/satellite operating process. Under the hub/satellite process, a satellite store shares reconditioning, purchasing and business office operations with a nearby hub store. The consumer offer is identical in both the hub and satellite stores. In fiscal 2000, management will focus on improving profitability in existing multi-store markets through the addition of satellite stores and new-car franchises. CarMax expects to open three additional used-car superstores, including one with a new-car franchise in fiscal 2000.

Merchandising. Each CarMax location features a broad selection of top-quality domestic and import used cars and trucks, with a wide range of prices appealing to a large range of potential customers. CarMax's selection covers the most popular brands, such as Ford, General Motors, Chrysler, Toyota, Honda, Nissan and Mitsubishi and specialty brands like Lexus and BMW. To appeal to the vast array of consumer preferences and budgets, CarMax offers its used vehicles under two programs - the CarMax program and the ValuMax program. CarMax used cars are generally in the current model year through five years old with fewer than 60,000 miles and range in price from $6,000 to $30,000. Through the ValuMax program, CarMax sells high-quality used vehicles that are either older or have higher mileage and generally range in price from $3,000 to $18,000. To ensure that CarMax quality standards are maintained, vehicles under both programs undergo a comprehensive, certified quality inspection by CarMax service technicians. CarMax backs its commitment to quality with a five-day or 250-mile, money-back guarantee and a limited warranty.

Most CarMax used cars are priced below retail book value. For new cars, CarMax's goal is to be competitive with the lowest available price in the market. All customers receive the same low price with no negotiating required. CarMax has extended its "no-haggle" philosophy to every stage of the vehicle transaction, including trade-ins, financing rates, extended warranty pricing and low vehicle documentation fees. CarMax has replaced the traditional "trade-in" transaction with a process in which trained CarMax buyers appraise any vehicle and provide the vehicle's owner with a written guaranteed cash offer that is good for seven days or 300 miles. The appraisal process is available to everyone, whether or not the individual is purchasing a vehicle from CarMax. In conjunction with Circuit City's in-store Roadshops, CarMax sells electronic accessories at its store locations.

Suppliers. In stores open for more than one year, CarMax acquires more than 50 percent of its used-vehicle inventory from consumers or from local and regional auctions in the markets that it serves. This buying strategy provides an inventory of makes and models that reflect the tastes of the market. CarMax appraises and makes an offer to purchase any properly documented vehicle from an individual. CarMax also acquires used vehicles directly from other sources, including wholesalers, franchised and independent dealers and fleet owners, such as leasing companies and rental companies. Based on consumer acceptance of the appraisal process at existing CarMax stores and the experience and success of CarMax to date in acquiring vehicles from auctions and other sources, management believes that its sources of used vehicles will continue to be sufficient to meet current needs and to support planned expansion.

New-car inventory for the franchise locations is provided under the terms of the sales and service agreements with DaimlerChrysler, Nissan, Mitsubishi, Toyota, Ford, Chevrolet, Cadillac, Subaru and BMW.

Reconditioning. An integral part of CarMax's used-car consumer offer is the reconditioning process. In fiscal 1998, management closed its centralized reconditioning facilities after experience proved that in-store reconditioning is more efficient and produces a higher quality vehicle for the consumer. In-market reconditioning by trained CarMax service technicians provides direct accountability to the customer, eliminates potential transportation damage to the vehicle and reduces transportation costs.

Advertising. Television and radio advertisements are designed to enhance consumer awareness of the CarMax name and key components of the CarMax offer. These advertisements are distinctly different from those placed by most auto dealers. Newspaper ads promote CarMax's selection and price leadership, targeting consumers with immediate purchase intentions. Advertising expenditures were 3.4 percent of sales in fiscal 1999 and 1998 and 2.3 percent of sales in fiscal 1997. Although markets were fully stored in fiscal 1999, advertising did not decline as a percentage of sales as originally anticipated. In fiscal 1999, new-car manufacturers intensified their promotional activities throughout the year resulting in sales below CarMax's expectations in all markets. The impact of lower sales resulting from the intense new-car competition substantially offsets the anticipated leverage of having more fully stored markets in fiscal 1999. During fiscal 1998, expansion left CarMax with five markets that were partially stored for much of the second half of the year. Because these new markets were not completely stored, initial advertising levels were below those of a fully stored market. While this approach worked successfully for the Atlanta entry three years ago, it did not create sufficient consumer awareness to drive expected levels of consumer traffic in fiscal 1998. As a consequence, CarMax instituted stepped-up awareness building campaigns in the third quarter of fiscal 1998 and advertising expense as a percentage of sales was above the fiscal 1997 level.

Franchises. CarMax operates new-car dealerships under separate franchise or dealer agreements with DaimlerChrysler, Nissan, Mitsubishi, Toyota, Ford, Chevrolet, Cadillac, Subaru and BMW. The agreements generally grant CarMax the right to sell the manufacturer's brand of vehicles and provide related parts and services within a specified market area. The designation of specified market areas generally does not guarantee exclusivity within a specified territory. The agreements govern the relationship between the dealership and the manufacturer and generally impose certain operational requirements and restrictions. These requirements include inventory levels, working capital, monthly financial reporting, signage and cooperation with marketing strategies. A manufacturer may terminate a dealer agreement under certain circumstances, including a change in ownership without prior manufacturer approval, failure to maintain adequate customer satisfaction ratings or a material breach or other provisions of the agreement. CarMax has also entered into framework agreements with several major vehicle manufacturers. These agreements generally contain provisions relating to the acquisition, ownership structure, management and operation of a dealership franchised by such manufacturers.

There are also various federal and state laws governing the relationship between automotive dealerships and vehicle manufacturers which might affect CarMax. These laws include statutes prohibiting manufacturers from terminating or failing to renew franchise agreements without proper cause and unreasonably withholding approval for proposed ownership changes.

Competition. The $650 billion used- and new-car retail business is highly competitive. In the used-vehicle market, CarMax competes with existing franchised and independent dealers, rental companies and private parties. Many franchised new-car dealerships also have increased their focus on the used-vehicle market. Part of CarMax's business strategy is to position itself as a low-price operator in the industry. In fiscal 1999, CarMax's used-car sales were negatively impacted by an intensely competitive new-car industry and insufficient customer traffic in a number of multi-store metropolitan markets.

In the new-vehicle market, CarMax competes with other franchised dealers offering vehicles produced by the same or other manufacturers and with auto brokers and leasing companies. As is typical of such arrangements, CarMax's existing franchise agreements do not guarantee exclusivity within a specified territory. Aggressive discounting by manufacturers of new cars, which typically occurs in the fall during the close-out of prior year models, may result in lower retail sales prices and margins for used vehicles during such discounting. In fiscal 1999, CarMax's new-car sales were strong resulting in part from the highly promotional climate in the new-car industry.

Customer Satisfaction. The elements of the CarMax offer are designed to create a customer-friendly experience. The "no-haggle" pricing allows the sales consultant to focus solely on the customer's needs. CarMax sales personnel play a significant role in ensuring a customer-friendly sales process. All sales consultants, including both full- and part-time employees, are compensated solely on a commission basis. The amount of the commission is a fixed dollar amount per vehicle sold. The entire purchase process, including a test-drive and financing, can be completed in less than one hour. Extensive market research is conducted to measure CarMax's customer service record and to refine its consumer offer.

Training. All of CarMax's Associates complete an initial orientation program entitled "The CarMax Way." This program is designed to ensure that all CarMax Associates deliver on its mission statement, which is to provide all customers with great quality cars at great prices with exceptional customer service. At the completion of fiscal 1999, the 30 location general managers averaged almost three years of CarMax experience and 12 years of prior management experience. Each store has eight to 18 inventory buyers. Each buyer undergoes a 12- to 24- month apprenticeship under the tutelage of an experienced buyer and appraises thousands of cars before making his or her first independent purchase. All sales consultants complete three weeks of additional training and receive ongoing training as new products and services become available. Most of CarMax's service technicians are ASE-certified, the industry standard for technician training.

Consumer Credit. CarMax provides prime financing for its customers' vehicle purchases through its finance operation or Bank of America. In addition, Chrysler Financial, BMW Financial, Ford Motor Credit, General Motors Acceptance, Mitsubishi Motors Credit, Nissan Motors Acceptance, Subaru American Credit and Toyota Motor Credit provide prime financing to customers purchasing new vehicles at applicable CarMax locations. Sub-prime financing is provided by TransSouth Financial at all CarMax locations and Franklin Acceptance on a regional basis, with no financial recourse to CarMax. Sales consultants use AutoMation(R) to electronically submit financing applications and receive responses from multiple lenders, generally in less than eight minutes.

Systems. AutoMation(R) is a unique, proprietary and enterprise-wide inventory management and sales system. Using a touch screen, CarMax customers can electronically search the inventory for cars that meet their specific needs. AutoMation(R) displays a color picture of the car and generates a vehicle information sheet for customer reference. After the selection process is complete, financing applications are submitted electronically and purchase and title forms are systematically generated, reducing customer wait time. The inventory management system includes bar codes on each vehicle and each on-site parking place. Daily scanning tracks movement of vehicles on the lot. An electronic gate helps track test drives for vehicles and sales consultants. This combination of systems allows inventory and sales performance to be closely monitored, enabling management to quickly resolve any issues.

Service. During fiscal 1998, CarMax completed the roll out of retail repair service to all locations. In fiscal 2000, CarMax intends to expand its retail service operations as its customer base expands. Extended warranty sales prior to July 1997 include third-party contracts and CarMax's own extended warranty contracts. In most states, CarMax sells warranties on behalf of an unrelated third party and has no contractual liability to the customer under the warranty programs. In states where third-party warranty sales are not permitted, CarMax has sold its own extended warranty. CarMax expects to continue selling this warranty where state law restricts third-party warranty sales. Contracts usually have terms of coverage between 12 and 72 months.

Seasonality. The business of CarMax is seasonal, with each location generally experiencing more of its net sales in the first half of the fiscal year. During the fall quarter, new-model-year introductions and discounting on close-out vehicles can cause rapid depreciation on used-car prices, especially on late-model vehicles. CarMax anticipates that the seasonality of its business may vary from region to region as its operations expand geographically.

Employees:

On April 30, 1999, the Company had 33,484 hourly and salaried employees and 20,946 sales employees working on a commission basis. None of the Company's employees are subject to a collective bargaining agreement. Additional personnel are employed during peak selling seasons. The Circuit City Group accounted for 30,000 of the Company's hourly and salaried employees and 19,362 of the Company's sales employees working on a commission basis. The CarMax Group accounted for 3,484 of the Company's hourly and salaried employees and 1,584 of the Company's sales employees working on a commission basis.

Item 2. Properties.

At April 30, 1999, the Company's Circuit City retail operations were conducted in 590 locations. The Company operates four Circuit City Superstore formats with square footage and merchandise assortments tailored to population and volume expectations for specific trade areas. The "D" format was developed to serve the most populous trade areas. At the end of fiscal 1999, selling space in the "D" format averaged approximately 23,000 square feet with total square footage averaging 43,042. The "C" format constitutes the largest percent of the store base. At the end of fiscal 1999 selling square footage in this format averaged 15,000 square feet with total square footage for all "C" stores averaging 34,036. The "B" format is often located in smaller markets or in trade areas that are on the fringes of larger metropolitan markets. At the end of fiscal 1999, selling space in these stores averaged approximately 12,500 square feet with an average total square footage of 26,651. The "B" stores offer a broad merchandise assortment that maximizes return on investment in these lower volume areas. The "A" format serves the least populated trade areas. Selling space in these stores averaged approximately 9,500 square feet at the end of fiscal 1999, and total square footage averaged 19,558. The "A" stores feature a layout, staffing levels and merchandise assortment that creates high productivity in the smallest markets.

The Company's 48 mall-based Circuit City Express stores are located in regional malls, are approximately 2,000 to 3,000 square feet in size and specialize in leading-edge technology.

The Company's CarMax operations were conducted in 32 locations as of April 30, 1999. In larger, metropolitan markets, CarMax has begun testing a hub/satellite operating process. Under the hub/satellite process, a satellite store shares reconditioning, purchasing and business office operations with a nearby hub store. The consumer offer is identical in both the hub and satellite stores. Prototypical satellite stores are expected to be approximately 12,000 square feet on four-to-six acre sites. CarMax opened one prototypical satellite store late in fiscal 1999. All other fiscal 1999 satellite stores are larger stores and are therefore classified by size, with "C" stores representing the largest store format. Going forward, management expects primarily to open smaller format "A" stores and satellite stores. In fiscal 1999, two locations were reclassed from "B" stores to "A" stores. The "Other" category in the following table under the CarMax Group includes two prototype satellite stores and three stand-alone, new-car stores.

The following table summarizes the Company's Circuit City and CarMax stores as of April 30, 1999:

	Circuit City Group							CarMax Group				
	Superstores				Electronics - Only	Mall Stores	Total	Superstores			Other	Total
	D	C	B	A				C	B	A		
Alabama	1	4	-	1	-	1	7	-	-	-	-	-
Arizona	2	6	2	-	-	1	11	-	-	-	-	-
Arkansas	-	2	-	2	-	-	4	-	-	-	-	-
California	16	52	11	2	-	4	85	-	-	-	-	-
Colorado	5	2	1	2	-	-	10	-	-	-	-	-
Connecticut	3	3	1	-	-	1	8	-	-	-	-	-
Delaware	-	2	-	-	-	1	3	-	-	-	-	-
District of Columbia	-	-	-	-	-	1	1	-	-	-	-	-
Florida	5	23	8	1	-	1	38	1	2	3	1	7
Georgia	4	7	5	-	-	3	19	1	-	2	-	3
Hawaii	1	-	-	-	-	-	1	-	-	-	-	-
Idaho	1	-	-	1	-	-	2	-	-	-	-	-
Illinois	6	19	4	-	-	4	33	3	-	1	-	4
Indiana	1	5	3	4	-	-	13	-	-	-	-	-
Kansas	1	3	-	-	-	-	4	-	-	-	-	-
Kentucky	-	5	-	1	-	-	6	-	-	-	-	-
Louisiana	-	5	-	2	-	1	8	-	-	-	-	-
Maine	-	-	1	-	-	-	1	-	-	-	-	-
Maryland	1	12	2	-	-	4	19	1	-	1	2	4
Massachusetts	1	9	3	-	-	6	19	-	-	-	-	-
Michigan	8	6	5	3	-	1	23	-	-	-	-	-
Minnesota	1	7	1	-	-	1	10	-	-	-	-	-
Mississippi	-	1	-	-	-	-	1	-	-	-	-	-
Missouri	1	9	1	-	-	1	12	-	-	-	-	-
Nebraska	1	1	-	-	-	-	2	-	-	-	-	-
Nevada	1	3	-	-	-	-	4	-	-	-	-	-
New Hampshire	-	4	-	-	-	2	6	-	-	-	-	-
New Jersey	1	6	2	-	-	-	9	-	-	-	-	-
New Mexico	1	-	-	-	-	-	1	-	-	-	-	-
New York	11	7	4	3	-	2	27	-	-	-	-	-
North Carolina	6	5	4	2	-	2	19	-	-	2	-	2
Ohio	7	12	5	-	-	3	27	-	-	-	-	-
Oklahoma	-	2	1	1	-	-	4	-	-	-	-	-
Oregon	2	5	-	1	-	-	8	-	-	-	-	-
Pennsylvania	2	12	3	2	-	2	21	-	-	-	-	-
Rhode Island	-	1	-	-	-	-	1	-	-	-	-	-
South Carolina	2	4	1	-	-	1	8	-	-	1	-	1
Tennessee	4	5	1	3	-	-	13	-	-	-	-	-
Texas	7	27	4	7	-	2	47	2	2	3	-	7
Utah	5	-	-	-	-	-	5	-	-	-	-	-
Vermont	-	-	1	-	-	-	1	-	-	-	-	-
Virginia	2	13	5	5	-	3	28	-	-	2	-	2
Washington	4	3	3	1	-	-	11	-	-	-	-	-
West Virginia	-	-	1	-	2	-	3	-	-	-	-	-
Wisconsin	4	2	1	-	-	-	7	-	-	-	2	2
	118	294	84	44	2	48	590	8	4	15	5	32

Of the stores open at April 30, 1999, the Company owns four Circuit City store locations and five CarMax store locations. The Company leases the remaining 586 Circuit City locations and 27 CarMax locations. During fiscal 2000, the Company anticipates entering into sale-leaseback transactions for one of the Circuit City locations and for all of the CarMax locations that were owned by the Company and open as of April 30, 1999.

For information with respect to obligations for Circuit City leases, see note 10 of the Notes to Circuit City Group Financial Statements on page 60 of the Company's 1999 Annual Report to Stockholders, which is incorporated herein by reference. For information with respect to obligations for CarMax leases, see note 12 of the Notes to CarMax Group Financial Statements on page 78 of the Company's 1999 Annual Report to Stockholders, which is incorporated herein by reference.

The Company owns a 388,000-square-foot consumer electronics/appliance distribution center in Doswell, Va., and a 387,000-square-foot consumer electronics/appliance distribution center in Atlanta, Ga. These distribution centers have been financed with Industrial Development Revenue Bonds.

The Company owns most of the land but leases the three buildings in which its corporate headquarters is located. The Company leases space for all warehouse, service and office facilities except for the aforementioned properties.

CIRCUIT CITY STORES, INC. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

On January 24, 1997, shareholders of Circuit City Stores, Inc. approved the creation of two common stock series. The Company's existing common stock was subsequently redesignated as Circuit City Stores, Inc.-Circuit City Group Common Stock. In an initial public offering, which was completed February 7, 1997, the Company sold 21.86 million shares of Circuit City Stores, Inc.-CarMax Group Common Stock.

The Circuit City Group Common Stock is intended to track the performance of the Circuit City store-related operations, the Company's investment in Digital Video Express and the Group's retained interest in the CarMax Group. The effects of this retained interest on the Circuit City Group's financial statements are identified by the term "Inter-Group."

The CarMax Group Common Stock is intended to track the performance of the CarMax operations. The Inter-Group Interest is not considered outstanding CarMax Group stock. Therefore, any net earnings or loss attributed to the Inter-Group Interest is not included in the CarMax Group's per share calculations.

The following discussion and analysis refers to Circuit City Stores, Inc., which includes the operations related to both the Circuit City Group and the CarMax Group. All financial statements reflect consummation of the CarMax Group stock offering on February 7, 1997. For additional information, refer to the "Management's Discussion and Analysis of Results of Operations and Financial Condition" for the Circuit City Group and for the CarMax Group.

RESULTS OF OPERATIONS

Sales Growth

Total sales for Circuit City Stores, Inc. increased 22 percent in fiscal 1999 to $10.80 billion. In fiscal 1998, total sales were $8.87 billion, a 16 percent increase from $7.66 billion in fiscal 1997.

PERCENTAGE SALES CHANGE FROM PRIOR YEAR

	Circuit City Stores, Inc.	Circuit City Group		CarMax Group	
Fiscal	Total	Total	Comparable	Total	Comparable
1999........	22%	17%	8 %	68%	(2)%
1998........	16%	12%	(1)%	71%	6 %
1997........	9%	6%	(8)%	85%	23 %
1996........	26%	23%	5 %	258%	12 %
1995........	35%	34%	15 %	376%	43 %

THE CIRCUIT CITY GROUP. Industry sales in Circuit City's retail segments have varied significantly over the past five years, resulting in wide variations in the Group's sales growth. Geographic expansion and the addition of product categories such as personal computers were the primary contributors to the Circuit City Group's total sales growth early in the period. From mid-fiscal 1996 through fiscal 1998, a lack of significant product introductions resulted in lower average retails and weak sales throughout the industry. In fiscal 1999, the industry began to emerge from this period of declining sales. For Circuit City, the fiscal 1999 sales reflected strong sales across all major categories with especially strong sales in personal computers and new high technology areas such as DIRECTV; wireless communications; DVD players, especially players with the Divx feature; and digital camcorders. The addition of 37 Superstores also contributed to the total sales growth.

The industry weakness in fiscal 1997 and 1998 resulted in a highly competitive climate, and a significant number of regional competitors closed stores. Despite the improvement in fiscal 1999, the consumer electronics industry remains highly competitive. Circuit City's primary competitors are large specialty, discount or warehouse retailers with generally lower levels of service. Because of Circuit City's long history of providing exceptional customer service, management believes that the Circuit City locations can continue to maintain share in existing markets and build comparable shares in new markets.

The Circuit City Group sells two extended warranty programs on behalf of unrelated third parties that issue these plans for merchandise sold by the Group and other retailers. These third-party programs are sold in most major markets. In states where third-party warranty sales are not permitted, the Group sells a Circuit City extended warranty. Gross dollar sales from all extended warranty programs were 5.4 percent of the Group's total sales in fiscal year 1999, compared with 5.5 percent in fiscal 1998 and 6.0 percent in fiscal 1997. The lower percentages in fiscal years 1999 and 1998 reflect the impact of lower average retail prices on consumer demand for the related warranties in many categories and increased sales of some products that carry lower warranty penetration rates. Total extended warranty revenue, which is reported in the Group's total sales, was 4.6 percent of sales in fiscal years 1999 and 1998 and 5.1 percent of sales in fiscal year 1997. The gross profit margins on products sold with extended warranties are higher than the gross profit margins on products sold without extended warranties. Third-party extended warranty revenue was 4.1 percent of the Group's total sales in fiscal year 1999 and 3.6 percent of the Group's total sales in fiscal years 1998 and 1997. The fiscal 1999 increase in third-party extended warranty revenue reflects the conversion of stores in 10 states to third-party warranty sales in June 1998.

THE CARMAX GROUP. The CarMax Group's fiscal 1999 total sales growth reflects the addition of 12 locations, three of which opened in the last week of the fiscal year, and a 2 percent decrease in comparable store sales. CarMax opened 10 used-car superstores in fiscal 1999. The Group grand-opened the Chicago, Ill., market with three stores that opened early in fiscal 1999 and one that opened late in fiscal 1998. The Group also entered San Antonio, Texas; and Greenville, S.C.; and added stores in the Washington, D.C./Baltimore, Md.; Tampa, Fla.; and Dallas/Ft. Worth, Texas, markets. The Group also acquired franchise rights or was awarded new franchise points for six new-car stores, including the nine-franchise Mauro Auto Mall, now operating as the CarMax Auto Mall, in Kenosha, Wis.

CarMax's fiscal 1999 comparable store sales reflect used-car sales that were below expectations and continued strength in CarMax's new-car comparable store sales. The disappointing used-car sales resulted from an intensely price-competitive new-car industry, with which CarMax must compete, and insufficient customer traffic in a number of multi-store metropolitan markets. CarMax is producing strong store-level returns in single-store markets and in the multi-store Atlanta, Ga., and Washington D.C./Baltimore, Md., markets.

In larger, metropolitan markets, CarMax has begun testing a hub/satellite operating process. Under the hub/satellite process, a satellite store shares reconditioning, purchasing and business office operations with a nearby hub store. The consumer offer is identical in both the hub and satellite stores. The hub/satellite process significantly reduced overhead and operating costs for

existing stores that were designated as satellite stores in fiscal 1999. Management believes this operating concept will allow it to efficiently open more but smaller stores in metropolitan markets. Prototypical satellite stores are expected to be approximately 12,000 square feet on four- to six-acre sites. CarMax opened one prototypical satellite store late in fiscal 1999. All other fiscal 1999 satellite stores are larger stores and are therefore classified by size, with "C" stores representing CarMax's largest store format. Going forward, management expects primarily to open smaller format "A" stores and satellite stores.

The fiscal 1998 sales growth reflects the addition of 11 locations, two of which opened in the last week of the fiscal year, and a 6 percent comparable store sales increase. The Group's used-car sales began to fall below management's expectations during the second half of fiscal 1998. New-car sales remained strong throughout that fiscal year. In June 1997, CarMax acquired its second Chrysler-Plymouth-Jeep franchise, which was relocated and opened in conjunction with the opening of the CarMax superstore in Stockbridge, Ga.

The fiscal 1997 sales growth includes the addition of three stores and a 23 percent comparable store sales increase for the two locations classified as comparable stores throughout the year and the two locations classified as comparable stores for a portion of the year.

Extended warranty sales prior to July 1997 include third-party contracts and CarMax's own extended warranty contracts. In most states, CarMax sells warranties on behalf of an unrelated third party and has no contractual liability to the customer under the warranty programs. In states where third-party warranty sales are not permitted, CarMax has sold its own extended warranty. CarMax expects to continue selling this warranty where state law restricts third-party warranty sales. Gross dollar sales from all extended warranty programs were 4.3 percent of the Group's total sales in fiscal 1999, 3.8 percent in fiscal 1998 and 3.5 percent in fiscal 1997. The fiscal 1999 increase reflects pricing adjustments and a higher penetration rate achieved by extending warranty coverage to more vehicles. Total extended warranty revenue, which is reported in the Group's total sales, was 2.0 percent of total sales in fiscal 1999, 1.5 percent in fiscal 1998 and 1.2 percent in fiscal 1997. Third-party extended warranty revenue was 1.9 percent of total sales in fiscal 1999, 1.4 percent in fiscal 1998 and 1.1 percent in fiscal 1997.

Digital Video Express

Digital Video Express has developed and is marketing a new digital video system for watching movies at home. Circuit City Stores, Inc. holds the majority interest in the business. The remaining interest is held by the prominent Los Angeles law firm Ziffren, Brittenham, Branca & Fischer. The Company's investment in Divx is allocated to the Circuit City Group. Through the end of the fiscal year, the Company had invested $207 million in Divx, $120 million of which was invested in fiscal 1999. The investment in Divx impacts the Company's and the Circuit City Group's gross profit margin and selling, general and administrative expense ratio.

Cost of Sales, Buying and Warehousing

The gross profit margin was 22.6 percent of sales in fiscal 1999 compared with 23.0 percent in fiscal years 1998 and 1997. The fiscal 1999 gross profit margin reflects a lower gross profit margin for the Circuit City Group and the higher percentage of sales from the CarMax Group. The Circuit City Group's gross profit margin was reduced by the strength of the personal computer business, which carries lower gross margins; the continued highly competitive price environment; and costs associated with Divx. Better inventory management and increased sales of new technologies and more fully featured products partly offset these factors. Because the CarMax business produces lower gross margins than the Circuit City business, the increased sales contribution from CarMax reduces the Company's overall gross profit margin even though the CarMax Group's gross profit margin increased from fiscal 1998 to fiscal 1999. The Company's fiscal 1998 gross margin reflects better inventory management and a stronger sales performance in higher margin categories for the Circuit City Group, offset by the higher sales contribution from the CarMax Group.

Selling, General and Administrative Expenses

Selling, general and administrative expenses were 20.2 percent of sales in fiscal 1999 compared with 20.8 percent in fiscal 1998 and 19.7 percent in fiscal 1997. The fiscal 1999 decrease primarily reflects the sales leverage gained from the Circuit City Group's comparable store sales increase, partly offset by the impact of selling, general and administrative expenses related to Divx. CarMax's lower expense structure reduces the Company's overall expense-to-sales ratio. The higher ratio in fiscal 1998 compared with fiscal 1997, reflects the impact of lower comparable store sales for the Circuit City Group, a decline in profits from the Circuit City Group's finance operation and the expenses related to Divx. Operating profits generated by the Company's finance operations are recorded as a reduction to selling, general and administrative expenses.

Interest Expense

Interest expense was 0.3 percent of sales in fiscal years 1999 and 1998 compared with 0.4 percent in fiscal 1997. Interest expense was incurred on debt used to fund store expansion, working capital and the investment in Divx.

Net Earnings

Net earnings for Circuit City Stores, Inc. increased 37 percent to $142.9 million in fiscal 1999. The increase reflects the 48 percent earnings increase achieved by the Circuit City business, partly offset by the investment in Digital Video Express and the CarMax Group losses. In fiscal 1998, net earnings were $104.3 million, a decrease of 24 percent from $136.4 million in fiscal 1997. Net earnings for all three fiscal years reflect the results of the Circuit City business, the Company's investment in Digital Video Express and the losses incurred by the CarMax Group.

FINANCIAL CONDITION

Liquidity and Capital Resources

In fiscal 1999, net cash provided by operating activities was $254.2 million compared with $194.6 million in fiscal 1998 and $14.2 million in fiscal 1997. The fiscal 1999 increase primarily reflects a decrease in net accounts receivable and higher earnings for the Circuit City business, partly offset by increased inventory for CarMax and the increased investment in Digital Video Express. The fiscal 1998 increase primarily reflects a reduction in inventory related to the Circuit City business, a smaller increase in net accounts receivable and a slight earnings increase for the Circuit City business, partly offset by the investment in Digital Video Express, greater automotive inventory to support a larger number of CarMax superstore openings and a higher loss from the CarMax business.

Most financial activities, including the investment of surplus cash and the issuance and repayment of short-term and long-term debt, are managed by the Company on a centralized basis. Interest-bearing loans, with terms determined by the board of directors, are used to manage cash between the Groups. These loans are reflected as inter-group receivables or payables on the financial statements of each Group.

Capital expenditures have been funded through sale-leaseback transactions, landlord reimbursements, proceeds from the CarMax Group equity offering and short- and long-term debt. Capital expenditures of $367.0 million in fiscal 1999 reflect Circuit City and CarMax stores opened or remodeled during the year and a portion of the stores opening in fiscal 2000. The sale-leaseback and landlord reimbursement transactions completed in fiscal 1999 totaled $273.6 million. Capital expenditures of $588.1 million in fiscal 1998 and $542.0 million in fiscal 1997 were largely incurred in connection with the Company's expansion programs. Sale-leaseback and landlord reimbursement transactions were $297.1 million in fiscal 1998 and $332.7 million in fiscal 1997.

During fiscal 1999, the CarMax Group acquired the Toyota franchise rights and the related assets of Laurel Automotive Group, Inc.; the franchise rights and the related assets of Mauro Auto Mall, Inc.; the franchise rights and the related assets of Nissan of Greenville, Inc.; and the Mitsubishi franchise rights and the related assets of Boomershine Automotive, Inc. for a total of $49.6 million. The acquisitions were financed through cash payments totaling $41.6 million and the issuance of two promissory notes totaling $8.0 million. Costs in excess of the acquired net tangible assets, which are primarily inventory, have been recorded as goodwill and covenants not to compete.

Receivables generated by the consumer finance operations are funded through securitization transactions that allow the operations to sell their receivables while retaining a small interest in them. The Circuit City Group's finance operation has a master trust securitization facility for its private-label credit card that allows the transfer of up to $1.38 billion in receivables through both private placement and the public market. A second master trust securitization program allows for the transfer of up to $1.75 billion in receivables related to the operation's bankcard programs. Receivables securitized under the master trust facilities totaled $2.76 billion at February 28, 1999. In fiscal 1996, Circuit City Stores, Inc. initiated an asset securitization program on behalf of the CarMax Group. At the end of fiscal 1999, that program allowed for the transfer of up to $575.0 million in auto loan receivables. At February 28, 1999, securitized receivables totaled $539.0 million. Under the securitization programs, receivables are sold to an unaffiliated third party with the servicing retained. Management expects that these securitization programs can be expanded to accommodate future receivables growth.

In fiscal 1999, CarMax entered into a $200.0 million one-year, renewable inventory financing arrangement with an asset-backed commercial paper conduit. The arrangement provides funding for the acquisition of vehicle inventory through the use of a non-affiliated special purpose company. As of February 28, 1999, CarMax had not yet used the financing facility; however, management expects the facility to be phased in during fiscal 2000 as various state regulatory requirements are met.

Capital Structure

Total assets at February 28, 1999, were $3.45 billion, up $213.6 million or 7 percent, since February 28, 1998. A $107.1 million increase in inventory contributed to the rise in total assets.

Over the past three years, expansion for the Groups has been funded with internally generated cash, sale-leaseback transactions, proceeds from the CarMax equity offering, operating leases and long-term debt. Consumer receivables have been funded through securitization transactions. Late in fiscal 1997, Circuit City Stores, Inc. raised a net of $412.3 million through the initial public offering of 21.86 million shares of newly created CarMax Group Common Stock. In fiscal 1997, the CarMax Group used approximately $187 million of the net proceeds to repay its allocated portion of Circuit City Stores, Inc. indebtedness. Management has used the remainder of the net proceeds to help finance the CarMax expansion. In fiscal 1997, the Company also entered into a five-year, $130 million unsecured bank term loan agreement.

During the period from fiscal 1995 to fiscal 1999, stockholders' equity grew substantially. From fiscal 1998 to fiscal 1999, stockholders' equity increased 10 percent to $1.91 billion. Capitalization for the past five years is illustrated in the "Capitalization" table below. Higher earnings for the Circuit City business, partly offset by the investment in Digital Video Express and losses from the CarMax Group, produced a return on equity of 7.9 percent in fiscal 1999 compared with 6.2 percent in fiscal 1998. The returns are below the Company's long-term objective but reflect the investments in the development and launch of the Divx system and the expansion of CarMax in fiscal years 1999 and 1998. In fiscal 1998, the challenging environment for Circuit City also contributed to the below-objective return.

Management believes that proceeds from sales of property and equipment and receivables, operating leases, equity issuances, CarMax's use of the renewable inventory financing facility and cash generated by operations will be sufficient to fund the capital expenditures of the Company. In fiscal 2000, management anticipates capital expenditures of approximately $315 million. At the end of fiscal 1999, the Company maintained a multi-year $150.0 million unsecured revolving credit agreement and $370.0 million in seasonal lines that are renewed annually with various banks.

Management remains in discussions with potential financing partners for Divx, but has not obtained any acceptable commitments to date. The Company has provided guarantees relating to licensing agreements with motion picture distributors for use of their films by the Divx system. The licensing fees are based on varying percentages of consumer viewing and wholesale receipts and require minimum distributor compensation commencing from the operational date of each agreement through the following one to five years.

The Groups rely on the external debt or equity of Circuit City Stores, Inc. to provide working capital needed to fund net assets not otherwise financed through operating income, sale-leasebacks or the securitization of receivables. All significant financial activities of each Group are managed by the Company on a centralized basis and are dependent on the financial condition of the Company. These financial activities include the investment of surplus cash, issuance and repayment of debt, securitization of receivables and sale-leasebacks of real estate.

CAPITALIZATION

Fiscal	1999		1998		1997		1996		1995	
(Dollar amounts in millions)	$	%	$	%	$	%	$	%	$	%
Long-term debt, excluding current installments.............	426.6	17	424.3	18	430.3	19	399.2	23	178.6	14
Other long-term liabilities.........	149.7	6	171.5	7	199.4	9	231.8	14	241.9	19
Total stockholders' equity..........	1,905.1	77	1,730.0	75	1,614.8	72	1,063.9	63	877.4	67
Total capitalization...........	2,481.4	100	2,325.8	100	2,244.5	100	1,694.9	100	1,297.9	100

MARKET RISK

The Company manages the private-label and bankcard revolving loan portfolios of the Circuit City Group's finance operation and the installment loan portfolio of the CarMax Group's finance operation. Portions of these portfolios are securitized and, therefore, are not presented on the Company's balance sheet. Interest rate exposure relating to these receivables represents a market risk exposure that the Company has managed with matched funding and interest rate swaps.

Revolving Loans

Interest rates charged on the managed private-label and bankcard portfolios are primarily indexed to the prime rate, adjustable on a monthly basis, with the balance at a fixed annual percentage rate. Total principal outstanding at February 28 had the following APR structure:

(Amounts in millions)	1999	1998
Indexed to prime rate....................	$2,714	$2,523
Fixed APR................................	243	227
Total....................................	$2,957	$2,750

Financing for the securitization programs is achieved primarily through the issuance of public market debt, which is issued either at floating rates based on LIBOR or at fixed rates. Certain of the fixed-rate issuances have been swapped to LIBOR. Receivables held by the Company for investment or sale are financed with working capital. At February 28, financings were as follows:

(Amounts in millions)	1999	1998
Floating-rate (including synthetic alteration) securitizations...........	$2,555	2,211
Fixed-rate securitizations	200	290
Held by the Company:		
For investment.......................	162	204
For sale.............................	40	45
Total....................................	$2,957	$2,750

Automobile Installment Loans

Total principal outstanding for fixed-rate automobile loans at February 28 was as follows:

(Amounts in millions)	1999	1998
Fixed APR	$592	$297

Financing for these receivables is achieved through bank conduit securitizations that, in turn, issue floating-rate securities. Interest rate exposure is hedged through the use of interest rate swaps matched to projected payoffs. Receivables held by the Company for investment or sale are financed with working capital.

Financings at February 28 and related interest rates were as follows:

(Amounts in millions)	1999	1998
Floating-rate securitizations synthetically altered to fixed	$500	$224
Floating-rate securitizations	39	44
Held by the Company:		
For investment	38	23
For sale	15	6
Total	$592	$297

The Company has analyzed its interest rate exposure and has concluded that it did not represent a material market risk at February 28, 1999 or 1998. Because programs are in place to manage interest rate exposure relating to the consumer loan portfolios, the Company expects to experience relatively little impact as interest rates fluctuate in the future. The Company also has the ability to adjust fixed-APR revolving cards and the index on floating-rate cards, subject to cardholder ratification, but does not currently anticipate the need to do so.

CONSOLIDATED STATEMENTS OF EARNINGS

Years Ended February 28

(Amounts in thousands except per share data)	1999	%	1998	%	1997	%
NET SALES AND OPERATING REVENUES	$10,804,447	100.0	$8,870,797	100.0	$7,663,811	100.0
Cost of sales, buying and warehousing	8,359,428	77.4	6,827,133	77.0	5,902,711	77.0
GROSS PROFIT	2,445,019	22.6	2,043,664	23.0	1,761,100	23.0
Selling, general and administrative expenses [NOTE 11]	2,186,177	20.2	1,848,559	20.8	1,511,294	19.7
Interest expense [NOTE 5]	28,319	0.3	26,861	0.3	29,782	0.4
TOTAL EXPENSES	2,214,496	20.5	1,875,420	21.1	1,541,076	20.1
Earnings before income taxes	230,523	2.1	168,244	1.9	220,024	2.9
Provision for income taxes [NOTE 6]	87,599	0.8	63,933	0.7	83,610	1.1
NET EARNINGS	$142,924	1.3	$104,311	1.2	$136,414	1.8
Net earnings (loss) attributed to [NOTES 1 AND 2]:						
Circuit City Group common stock	$148,381		$112,074		$136,680	
CarMax Group common stock	(5,457)		(7,763)		(266)	
	$142,924		$104,311		$136,414	
Weighted average common shares [NOTES 2 AND 8]:						
Circuit City Group:						
Basic	99,152		98,027		97,311	
Diluted	100,406		99,204		98,472	
CarMax Group	22,604		22,001		21,860	

CONSOLIDATED BALANCE SHEETS

(Amounts in thousands except share data)	At February 28 1999	1998
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$265,880	$116,612
Net accounts receivable [NOTE 12]	574,316	598,035
Inventory	1,517,675	1,410,545
Prepaid expenses and other current assets	36,644	21,157
TOTAL CURRENT ASSETS	2,394,515	2,146,349
Property and equipment, net [NOTES 4 AND 5]	1,005,773	1,048,434
Other assets	44,978	36,918
TOTAL ASSETS	$3,445,266	$3,231,701

LIABILITIES AND STOCKHOLDERS' EQUITY

CURRENT LIABILITIES:		
Current installments of long-term debt [NOTES 5 AND 10]	$2,707	$1,301
Accounts payable	799,733	765,391
Short-term debt [NOTE 5]	8,016	5,976
Accrued expenses and other current liabilities	143,585	132,802
Deferred income taxes [NOTE 6]	9,764	356
TOTAL CURRENT LIABILITIES	963,805	905,826
Long-term debt, excluding current installments [NOTES 5 AND 10]	426,585	424,292
Deferred revenue and other liabilities	112,085	145,107
Deferred income taxes [NOTE 6]	37,661	26,437
TOTAL LIABILITIES	1,540,136	1,501,662
STOCKHOLDERS' EQUITY [NOTES 1 AND 7]:		
Circuit City Group common stock, $0.50 par value; 175,000,000 shares authorized; 100,820,000 shares issued and outstanding (99,282,000 in 1998)	50,410	49,641
CarMax Group common stock, $0.50 par value; 175,000,000 shares authorized; 23,116,000 shares issued and outstanding (22,204,000 in 1998)	11,558	11,102
Capital in excess of par value	575,686	530,763
Retained earnings	1,267,476	1,138,533
TOTAL STOCKHOLDERS' EQUITY	1,905,130	1,730,039
Commitments and contingent liabilities [NOTES 1, 9, 10, 12, 13 AND 14]		
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$3,445,266	$3,231,701

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Amounts in thousands)	Years Ended February 28 1999	1998	1997
OPERATING ACTIVITIES:			
Net earnings	$142,924	$104,311	$136,414
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation and amortization	140,293	116,326	98,977
Loss (gain) on disposition of property and equipment	3,087	14,093	(1,540)
Provision for deferred income taxes	20,632	15,052	20,973
Changes in operating assets and liabilities, net of effects from business acquisitions:			
Decrease in deferred revenue and other liabilities	(33,022)	(23,024)	(47,706)
Decrease (increase) in net accounts receivable	23,719	(66,061)	(207,579)
Increase in inventory, prepaid expenses and other current assets	(97,642)	(24,526)	(66,594)
Decrease (increase) in other assets	9,132	(4,969)	(15,869)
Increase in accounts payable, accrued expenses and other current liabilities	45,125	63,379	97,162
NET CASH PROVIDED BY OPERATING ACTIVITIES	254,248	194,581	14,238
INVESTING ACTIVITIES:			
Cash used in business acquisitions [NOTE 3]	(41,562)	-	-
Purchases of property and equipment	(366,971)	(588,052)	(541,989)
Proceeds from sales of property and equipment	273,647	297,126	332,726
NET CASH USED IN INVESTING ACTIVITIES	(134,886)	(290,926)	(209,263)
FINANCING ACTIVITIES:			
(Payments on) proceeds from issuance of short-term debt, net	(960)	5,629	(91,740)
Proceeds from issuance of long-term debt	-	-	32,619
Principal payments on long-term debt	(1,301)	(6,187)	(1,436)
Issuances of Circuit City Group common stock, net	42,165	22,311	15,385
Issuances of CarMax Group common stock, net	3,983	2,353	412,335
Dividends paid on Circuit City Group common stock	(13,981)	(13,792)	(13,199)
NET CASH PROVIDED BY FINANCING ACTIVITIES	29,906	10,314	353,964
Increase (decrease) in cash and cash equivalents	149,268	(86,031)	158,939
Cash and cash equivalents at beginning of year	116,612	202,643	43,704
Cash and cash equivalents at end of year	$265,880	$116,612	$202,643
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION			
Cash paid during the year for:			
Interest	$31,858	$26,697	$29,925
Income taxes	$53,528	$47,936	$73,113

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(Amounts in thousands except per share data)	Common Shares Outstanding Circuit City Group	Common Shares Outstanding CarMax Group	Common Stock Circuit City Group	Common Stock CarMax Group	Capital In Excess of Par Value	Retained Earnings	Total
BALANCE AT MARCH 1, 1996........................	97,380	-	$48,690	$-	$90,432	$924,799	$1,063,921
Net earnings................................	-	-	-	-	-	136,414	136,414
Exercise of common stock options [NOTE 7].....	786	-	393	-	13,497	-	13,890
Shares issued under Employee Stock Purchase Plan [NOTE 7]..............	78	-	39	-	2,491	-	2,530
Shares issued under the 1994 Stock Incentive Plan [NOTE 7]....................	255	-	127	-	7,455	-	7,582
Tax benefit from stock issued.................	-	-	-	-	3,080	-	3,080
Shares issued in the CarMax Group stock offering................................	-	21,860	-	10,930	401,405	-	412,335
Shares cancelled upon reacquisition by Company	(321)	-	(160)	-	(9,654)	-	(9,814)
Unearned compensation-restricted stock........	-	-	-	-	(1,883)	-	(1,883)
Cash dividends-Circuit City Group common stock ($0.14 per share)....................	-	-	-	-	-	(13,199)	(13,199)
BALANCE AT FEBRUARY 28, 1997....................	98,178	21,860	49,089	10,930	506,823	1,048,014	1,614,856
Net earnings................................	-	-	-	-	-	104,311	104,311
Exercise of common stock options [NOTE 7].....	483	273	241	136	6,790	-	7,167
Shares issued under Employee Stock Purchase Plans [NOTE 7].............	173	51	87	26	6,648	-	6,761
Shares issued under the 1994 Stock Incentive Plan [NOTE 7]....................	605	20	302	10	20,214	-	20,526
Tax benefit from stock issued.................	-	-	-	-	8,013	-	8,013
Shares cancelled upon reacquisition by Company	(157)	-	(78)	-	(4,470)	-	(4,548)
Unearned compensation-restricted stock........	-	-	-	-	(13,255)	-	(13,255)
Cash dividends-Circuit City Group common stock ($0.14 per share)....................	-	-	-	-	-	(13,792)	(13,792)
BALANCE AT FEBRUARY 28, 1998....................	99,282	22,204	49,641	11,102	530,763	1,138,533	1,730,039
Net earnings................................	-	-	-	-	-	142,924	142,924
Exercise of common stock options [NOTE 7].....	1,004	543	502	272	16,945	-	17,719
Shares issued under Employee Stock Purchase Plans [NOTE 7].............	429	269	215	134	19,431	-	19,780
Shares issued under the 1994 Stock Incentive Plan [NOTE 7]....................	360	100	180	50	14,588	-	14,818
Tax benefit from stock issued.................	-	-	-	-	9,523	-	9,523
Other..	32	-	16	-	1,445	-	1,461
Shares cancelled upon reacquisition by Company	(287)	-	(144)	-	(14,239)	-	(14,383)
Unearned compensation-restricted stock........	-	-	-	-	(2,770)	-	(2,770)
Cash dividends-Circuit City Group common stock ($0.14 per share)....................	-	-	-	-	-	(13,981)	(13,981)
BALANCE AT FEBRUARY 28, 1999....................	100,820	23,116	$50,410	$11,558	$575,686	$1,267,476	$1,905,130

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

On January 24, 1997, shareholders of Circuit City Stores, Inc. and its subsidiaries approved the creation of two common stock series. The Company's existing common stock was subsequently redesignated as Circuit City Stores, Inc.-Circuit City Group Common Stock. In an initial public offering, which was completed February 7, 1997, the Company sold 21.86 million shares of Circuit City Stores, Inc.-CarMax Group Common Stock.

The Circuit City Group Common Stock is intended to track the performance of the Circuit City store-related operations, the Company's investment in Digital Video Express and the Group's retained interest in the CarMax Group. The CarMax Group Common Stock is intended to track the performance of the CarMax operations. The Circuit City Group held a 76.6 percent interest in the CarMax Group at February 28, 1999, a 77.3 percent interest at February 28, 1998, and a 77.5 percent interest at February 28, 1997.

Notwithstanding the attribution of the Company's assets and liabilities (including contingent liabilities) and stockholders' equity between the Circuit City Group and the CarMax Group for the purposes of preparing their respective financial statements, holders of Circuit City Stock and holders of CarMax Stock are shareholders of the Company and continue to be subject to all of the risks associated with an investment in the Company and all of its businesses, assets and liabilities. Such attribution and the change in the equity structure of the Company does not affect title to the assets or responsibility for the liabilities of the Company or any of its subsidiaries. The results of operations or financial condition of one Group could affect the results of operations or financial condition of the other Group. Accordingly, the Company's consolidated financial statements included herein should be read in conjunction with the financial statements of each Group.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(A) PRINCIPLES OF CONSOLIDATION: The consolidated financial statements include the accounts of the Circuit City Group, including Divx, and the CarMax Group, which combined comprise all accounts of the Company. All significant intercompany balances and transactions have been eliminated in consolidation.

(B) CASH AND CASH EQUIVALENTS: Cash equivalents of $216,129,000 at February 28, 1999, and $71,750,000 at February 28, 1998, consist of highly liquid debt securities with original maturities of three months or less.

(C) TRANSFERS AND SERVICING OF FINANCIAL ASSETS: The Company adopted Statement of Financial Accounting Standards No. 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," effective January 1, 1997. For transfers that qualify as sales, the Company recognizes gains or losses as a component of the Company's finance operations. For transfers of financial assets to qualify for sale accounting, control over the assets must be surrendered at the time of sale. Multiple estimates are used to calculate the gain or loss on sales of receivables under SFAS No. 125. Finance charge income, default rates and payment rates are estimated using projections developed from the prior 12 months of operating history. These estimates are adjusted for any industry or portfolio trends that have been observed. The resulting cash flow projections are present valued at a discount rate appropriate for the type of asset and risk. Retained interests (such as residual interests in a securitization trust, cash reserve accounts and rights to future interest from serviced assets that exceed contractually specified servicing fees) are included in net accounts receivable and are carried at fair value with changes in fair value reflected in earnings. Loan receivables held for sale are carried at the lower of cost or market, whereas loan receivables held for investment are carried at cost less an allowance for losses. At February 28, 1999 and 1998, cost approximates fair value.

(D) FAIR VALUE OF FINANCIAL INSTRUMENTS: The carrying value of the Company's financial instruments, excluding interest rate swaps held for hedging purposes, approximates fair value. Credit risk is the exposure created by the potential nonperformance of another material party to an agreement due to changes in economic, industry or geographic factors. The Company mitigates credit risk by dealing only with counterparties that are highly rated by several financial rating agencies. Accordingly, the Company does not anticipate material loss for nonperformance. The Company broadly diversifies all financial instruments along industry, product and geographic areas.

(E) INVENTORY: Inventory is stated at the lower of cost or market. Cost is determined by the average cost method for the Circuit City Group's inventory and by specific identification for the CarMax Group's vehicle inventory. Parts and labor used to recondition vehicles, as well as transportation and other incremental expenses associated with acquiring vehicles, are included in the CarMax Group's inventory.

(F) PREPAID ROYALTIES AND EXECUTION FEES: Prepaid royalties represent fixed minimum advance payments made to licensors for digital video disc distribution rights. Divx retains a licensor's share of distribution revenues until the share equals the advance paid to the licensor. Thereafter, any excess distribution revenue is paid to the licensor. Prepaid royalties are charged to operations as revenues are earned. Execution fees are one-time payments made to licensors at the time the related licensing agreements are executed and are amortized over the shorter of the initial terms of the licensing agreements or five years. Both the prepaid royalties and execution fees are stated at the lower of amortized cost or estimated net realizable value on a license-agreement basis.

(G) PROPERTY AND EQUIPMENT: Property and equipment is stated at cost less accumulated depreciation and amortization. Depreciation and amortization are calculated using the straight-line method over the assets' estimated useful lives.

Property held under capital lease is stated at the lower of the present value of the minimum lease payments at the inception of the lease or market value and is amortized on a straight-line basis over the lease term or the estimated useful life of the asset, whichever is shorter.

(H) COMPUTER SOFTWARE COSTS: Effective March 1, 1998, the Company adopted the American Institute of Certified Public Accountants Statement of Position 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." Once the capitalization criteria of the SOP have been met, external direct costs of materials and services used in the development of internal-use software and payroll and payroll-related costs for employees directly involved in the development of internal-use software are capitalized. Amounts capitalized are amortized on a straight-line basis over a period of three to five years.

(I) INTANGIBLE ASSETS: Amounts paid for acquired businesses in excess of the fair value of the net tangible assets acquired are recorded as goodwill, which is amortized on a straight-line basis over 15 years, and covenants not to compete, which are amortized on a straight-line basis over the life of the covenant not to exceed five years. Both goodwill and covenants not to compete are included in other assets on the accompanying consolidated balance sheets. The carrying value of intangible assets is periodically reviewed by the Company and impairments are recognized when the expected future undiscounted operating cash flows derived from such intangible assets are less than the carrying value.

(J) PRE-OPENING EXPENSES: Expenses associated with the opening of new stores are deferred and amortized ratably over the period from the date of the store opening to the end of the fiscal year.

(K) INCOME TAXES: The Company accounts for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes." Deferred income taxes reflect the impact of temporary differences between the amounts of assets and liabilities recognized for financial reporting purposes and the amounts recognized for income tax purposes, measured by applying currently enacted tax laws. The Company recognizes deferred tax assets if it is more likely than not that a benefit will be realized.

(L) DEFERRED REVENUE: The Circuit City Group sells its own extended warranty contracts and extended warranty contracts on behalf of unrelated third parties. The contracts extend beyond the normal manufacturer's warranty period, usually with terms (including the manufacturer's warranty period) between 12 and 60 months. All revenue from the sale of the Circuit City Group's own extended warranty contracts is deferred and amortized on a straight-line basis over the life of the contracts. Incremental direct costs related to the sale of contracts are deferred and charged to expense in proportion to the revenue recognized. Commission revenue for the unrelated third-party extended warranty plans is recognized at the time of sale.

The CarMax Group sells service contracts on behalf of unrelated third parties and, prior to July 1997, sold its own contracts at one location where third-party warranty sales were not permitted. Contracts usually have terms of coverage between 12 and 72 months. All revenue from the sale of the CarMax Group's own service contracts is deferred and amortized over the life of the contracts consistent with the pattern of repair experience of the industry. Incremental direct costs related to the sale of contracts are deferred and charged to expense in proportion to the revenue recognized. Commission revenue for the unrelated third-party service contracts is recognized at the time of sale.

(M) SELLING, GENERAL AND ADMINISTRATIVE EXPENSES: Operating profits generated by the Company's finance operations are recorded as a reduction to selling, general and administrative expenses.

(N) ADVERTISING EXPENSES: All advertising costs are expensed as incurred.

(O) NET EARNINGS (LOSS) PER SHARE: On December 15, 1997, the Company adopted SFAS No. 128, "Earnings per Share." All prior period earnings per share data presented has been restated to conform with the provisions of SFAS No. 128.

Basic net earnings per share for Circuit City Stock is computed by dividing net earnings attributed to Circuit City Stock, including the Circuit City Group's 100 percent interest in the losses of the CarMax Group for periods prior to the offering and the Circuit City Group's retained interest in the CarMax Group subsequent to the offering, by the weighted average number of shares of Circuit City Stock outstanding. Diluted net earnings per share for Circuit City Stock is computed by dividing net earnings attributed to Circuit City Stock, which includes the Circuit City Group's retained interest in CarMax, by the weighted average number of shares of Circuit City Stock outstanding and dilutive potential Circuit City Stock.

Net loss per share for CarMax Stock is computed by dividing the net loss attributed to CarMax Stock by the weighted average number of shares of CarMax Stock outstanding. Diluted net loss per share for CarMax Stock is not calculated since CarMax has a net loss for the periods presented.

(P) STOCK-BASED COMPENSATION: On March 1, 1996, the Company adopted SFAS No. 123, "Accounting for Stock-Based Compensation." The Company has elected to continue applying the provisions of the Accounting Principles Board Opinion No. 25, "Accounting For Stock Issued to Employees," and to provide the pro forma disclosures of SFAS No. 123.

(Q) DERIVATIVE FINANCIAL INSTRUMENTS: The Company enters into interest rate swap agreements to manage exposure to interest rates and to more closely match funding costs to the use of funding. Interest rate swaps relating to long-term debt are classified as held for purposes other than trading and are accounted for on a settlement basis. To qualify for this accounting treatment, the swap must synthetically alter the nature of a designated underlying financial instrument. Under this method, payments or receipts due or owed under the swap agreement are accrued through each settlement date and recorded as a component of interest expense. If a swap designated as a synthetic alteration were to be terminated, any gain or loss on the termination would be deferred and recognized over the shorter of the original contractual life of the swap or the related life of the designated long-term debt. The Company also enters into interest rate swap agreements as part of its asset securitization programs. Swaps entered into by a seller as part of a sale of financial assets are considered proceeds at fair value in the determination of the gain or loss on the sale. If such a swap were terminated, the impact on the fair value of the financial asset created by the sale of the related receivables would be estimated and included in earnings.

(R) RISKS AND UNCERTAINTIES: Circuit City is a leading national retailer of brand-name consumer electronics, personal computers, major appliances and entertainment software. The diversity of Circuit City's products, customers, suppliers and geographic operations significantly reduces the risk that a severe impact will occur in the near term as a result of changes in its customer base, competition, sources of supply or markets. It is unlikely that any one event would have a severe impact on the Company's operating results.

Because of its investment in Divx, the Company is subject to additional risks and uncertainties. Divx was formed to develop and launch an enhancement for DVD players that provides significant copyright protection for movies released on Divx digital discs and sets a new standard for home video convenience. While management believes this product will gain widespread acceptance, there is no assurance that Divx ever will achieve significant sales of such product. Other risks include limited operating history, no assurance of successful operations, early state of market development, acquiring and maintaining licensing and manufacturing agreements, minimum compensation requirements under studio license agreements, competition from substitute products and services, rapid technological change, dependence on key personnel and vendors, development or assertions by or against Divx relating to intellectual property rights, and the uncertainty of availability of additional financing.

The CarMax Group is a used- and new-car retail business. The diversity of the CarMax Group's customers and suppliers reduces the risk that a severe impact will occur in the near term as a result of changes in its customer base or sources of supply. However, due to the CarMax Group's limited overall size, management cannot assure that unanticipated events will not have a negative impact on the Company.

(S) CORPORATE ALLOCATIONS: The Company manages corporate general and administrative costs and other shared services on a centralized basis. Allocations of these corporate activities and their related expenses to the Groups is based on methods that the Company believes to be reasonable.

The provision for federal income taxes is determined on a consolidated basis. The financial statement provision is reflected in each Group's financial statements in accordance with the Company's tax allocation policy. In general, this policy provides that the consolidated tax provision be allocated between the Groups based principally upon the financial income, taxable income, credits and other amounts directly related to the respective Group. Tax benefits that cannot be used by the Group generating such attributes, but can be utilized on a consolidated basis, are allocated to the Group that generated such benefits.

3. BUSINESS ACQUISITIONS During fiscal 1999, CarMax acquired the franchise rights and the related assets of four new-car dealerships for an aggregate cost of $49.6 million. The acquisitions were financed through available cash resources and the issuance of two promissory notes aggregating $8.0 million. Costs in excess of the fair value of the net tangible assets acquired (primarily inventory) have been recorded as goodwill and covenants not to compete. These acquisitions were accounted for under the purchase method and the results of the operations of the acquired franchises have been included in the accompanying consolidated financial statements since the date of acquisition. Unaudited pro-forma informationrelated to these acquisitions is not included as the impact of these acquisitions on the accompanying consolidated financial statements is not deemed to be material.

4. PROPERTY AND EQUIPMENT
Property and equipment, at cost, at February 28 is summarized as follows:

(Amounts in thousands)	1999	1998
Land and buildings (20 to 25 years)..	$107,310	$143,905
Land held for development...........	28,781	11,601
Construction in progress.............	179,664	237,205
Furniture, fixtures and equipment (3 to 8 years)....................	705,660	615,564
Leasehold improvements (10 to 15 years)..................	549,673	483,069
Capital leases, primarily buildings (20 years)........................	12,471	12,471
	1,583,559	1,503,815
Less accumulated depreciation and amortization.....................	577,786	455,381
Property and equipment, net.........	$1,005,773	$1,048,434

5. DEBT

Long-term debt at February 28 is summarized as follows:

(Amounts in thousands)	1999	1998
Term loans	$405,000	$405,000
Industrial Development Revenue Bonds due through 2006 at various prime-based rates of interest ranging from 5.0% to 7.0%	6,564	7,665
Obligations under capital leases [NOTE 10]	12,728	12,928
Note payable	5,000	-
Total long-term debt	429,292	425,593
Less current installments	2,707	1,301
Long-term debt, excluding current installments	$426,585	$424,292

In July 1994, the Company entered into a seven-year, $100,000,000, unsecured bank term loan. The loan was restructured in August 1996 as a $100,000,000, six-year unsecured bank term loan. Principal is due in full at maturity with interest payable periodically at LIBOR plus 0.40 percent. At February 28, 1999, the interest rate on the term loan was 5.76 percent.

In May 1995, the Company entered into a five-year, $175,000,000, unsecured bank term loan. Principal is due in full at maturity with interest payable periodically at LIBOR plus 0.35 percent. At February 28, 1999, the interest rate on the term loan was 5.67 percent.

In June 1996, the Company entered into a five-year, $130,000,000, unsecured bank term loan. Principal is due in full at maturity with interest payable periodically at LIBOR plus 0.35 percent. At February 28, 1999, the interest rate on the term loan was 5.29 percent.

The Company maintains a multi-year, $150,000,000, unsecured revolving credit agreement with four banks. The agreement calls for interest based on both committed rates and money market rates and a commitment fee of 0.13 percent per annum. The agreement was entered into as of August 31, 1996, and terminates August 31, 2002. No amounts were outstanding under the revolving credit agreement at February 28, 1999 or 1998.

The Industrial Development Revenue Bonds are collateralized by land, buildings and equipment with an aggregate carrying value of approximately $10,740,000 at February 28, 1999, and $10,879,000 at February 28, 1998.

In November 1998, CarMax entered into a four-year, unsecured $5,000,000 promissory note. Principal is due annually with interest payable periodically at 8.25 percent.

In fiscal 1999, CarMax entered into a $200,000,000 one-year, renewable inventory financing arrangement with an asset-backed commercial paper conduit. The arrangement will provide funding for the acquisition of vehicle inventory through the use of a non-affiliated special purpose company. During fiscal 1999, no inventory was financed by CarMax under this arrangement.

The scheduled aggregate annual principal payments on long-term obligations for the next five fiscal years are as follows: 2000 - $2,707,000; 2001 - $177,344,000; 2002 - $132,485,000; 2003 - $102,594,000; 2004 - $1,507,000.

Under certain of the debt agreements, the Company must meet financial covenants relating to minimum tangible net worth, current ratios and debt-to-capital ratios. The Company was in compliance with all such covenants at February 28, 1999 and 1998.

Short-term debt is funded through committed lines of credit and informal credit arrangements, as well as the revolving agreement. Amounts outstanding and committed lines of credit available are as follows:

(Amounts in thousands)	Years Ended February 28 1999	1998
Average short-term debt outstanding......	$54,505	$48,254
Maximum short-term debt outstanding......	$463,000	$414,000
Aggregate committed lines of credit......	$370,000	$410,000

The weighted average interest rate on the outstanding short-term debt was 5.1 percent during fiscal 1999, 5.7 percent during fiscal 1998 and 5.4 percent during fiscal 1997.

The Company capitalizes interest in connection with the construction of certain facilities and software developed or obtained for internal use. In fiscal 1999, interest capitalized amounted to $5,423,000 ($9,638,000 in fiscal 1998 and $6,970,000 in fiscal 1997).

6. INCOME TAXES

The Company files a consolidated federal income tax return. The components of the provision for income taxes are as follows:

(Amounts in thousands)	Years Ended February 28 1999	1998	1997
Current:			
Federal........................	**$59,134**	**$46,475**	**$55,673**
State..........................	**7,833**	**2,406**	**6,964**
	66,967	**48,881**	**62,637**
Deferred:			
Federal........................	**20,013**	**12,801**	**19,839**
State..........................	**619**	**2,251**	**1,134**
	20,632	**15,052**	**20,973**
Provision for income taxes........	**$87,599**	**$63,933**	**$83,610**

The effective income tax rate differed from the Federal statutory income tax rate as follows:

	Years Ended February 28		
	1999	1998	1997
Federal statutory income tax rate	35.0%	35.0%	35.0%
State and local income taxes, net of Federal benefit	3.0	3.0	3.0
Effective income tax rate	38.0%	38.0%	38.0%

In accordance with SFAS No. 109, the tax effects of temporary differences that give rise to a significant portion of the deferred tax assets and liabilities at February 28, 1999 and 1998, are as follows:

(Amounts in thousands)	1999	1998
Deferred tax assets:		
Deferred revenue	$8,332	$1,360
Inventory capitalization	2,578	4,976
Accrued expenses	27,080	42,554
Other	5,430	3,638
Total gross deferred tax assets	43,420	52,528
Deferred tax liabilities:		
Depreciation and amortization	48,035	45,118
Gain on sales of receivables	14,990	11,439
Other prepaid expenses	12,062	10,569
Other	15,758	12,195
Total gross deferred tax liabilities	90,845	79,321
Net deferred tax liability	$47,425	$26,793

Based on the Company's historical and current pretax earnings, management believes the amount of gross deferred tax assets will be realized through future taxable income; therefore, no valuation allowance is necessary.

7. CAPITAL STOCK AND STOCK INCENTIVE PLANS

(A) PREFERRED STOCK: In conjunction with the Company's Shareholders Rights Plan as amended and restated, preferred stock purchase rights were distributed as a dividend at the rate of one right for each share of Circuit City Stock and CarMax Stock. The rights are exercisable only upon the attainment of, or the commencement of a tender offer to attain, a specified ownership interest in the Company by a person or group. When exercisable, each Circuit City right would entitle shareholders to buy one four-hundredth of a share of Cumulative Participating Preferred Stock, Series E, $20 par value, at an exercise price of $250 per share subject to adjustment. Each CarMax right, when exercisable, would entitle shareholders to buy one four-hundredth of a share of Cumulative Participating Preferred Stock, Series F, $20 par value, at an exercise price of $100 per share subject to adjustment. A total of 1,000,000 shares of such preferred stock, which have preferential dividend and liquidation rights, have been designated. No such shares are outstanding. In the event that an acquiring person or group acquires the specified ownership percentage of the Company's common stock (except pursuant to a cash tender offer for all outstanding shares determined to be fair by the board of directors) or engages in certain transactions with the Company after the rights become exercisable, each right will be converted into a right to purchase, for half the current market price at that time, shares of the related Group stock valued at two times the exercise price.

The Company also has 1,000,000 shares of undesignated preferred stock authorized of which no shares are outstanding.

(B) VOTING RIGHTS: The holders of both series of common stock and any series of preferred stock outstanding and entitled to vote together with the holders of common stock will vote together as a single voting group on all matters on which common shareholders generally are entitled to vote other than a matter on which the common stock or either series thereof or any series of preferred stock would be entitled to vote as a separate voting group. On all matters on which both series of common stock would vote together as a single voting group, (i) each outstanding share of Circuit City Stock shall have one vote and (ii) each outstanding share of CarMax Stock shall have a number of votes based on the weighted average ratio of the market value of a share of CarMax Stock to a share of Circuit City Stock. If shares of only one series of common stock are outstanding, each share of that series shall be entitled to one vote. If either series of common stock is entitled to vote as a separate voting group with respect to any matter, each share of that series shall, for purposes of such vote, be entitled to one vote on such matter.

(C) RESTRICTED STOCK: The Company has issued restricted stock under the provisions of the 1994 Stock Incentive Plan whereby management and key employees are granted restricted shares of Circuit City Stock or CarMax Stock. Shares are awarded in the name of the employee, who has all the rights of a stockholder, subject to certain restrictions or forfeitures. Restrictions on the awards generally expire three to seven years from the date of grant. In fiscal 1999, certain members of management of the Circuit City Group were granted 131,350 restricted shares of Circuit City Stock that vest seven years from the date of grant. These awards provide accelerated vesting if certain performance factors are met. Total restricted stock awards of 360,346 shares of Circuit City Stock and 100,000 shares of CarMax Stock were granted to eligible employees in fiscal 1999. The market value at the date of grant of these shares has been recorded as unearned compensation and is a component of stockholders' equity. Unearned compensation is expensed over the restriction periods. In fiscal 1999, a total of $9,167,700 was charged to operations ($5,073,100 in fiscal 1998 and

$3,790,200 in fiscal 1997). As of February 28, 1999, 966,053 restricted shares of Circuit City Stock and 120,000 restricted shares of CarMax Stock were outstanding.

(D) EMPLOYEE STOCK PURCHASE PLANS: The Company has Employee Stock Purchase Plans for all employees meeting certain eligibility criteria. Under the Circuit City Plan and, starting in April 1997, under the CarMax Plan, eligible employees may purchase shares of Circuit City Stock or CarMax Stock, subject to certain limitations, at 85 percent of market value. Purchases are limited to 10 percent of an employee's eligible compensation, up to a maximum of $7,500 per year. At February 28, 1999, a total of 683,015 shares remained available under the Circuit City Plan and 138,693 shares remained available under the CarMax Plan. During fiscal 1999, 429,355 shares of Circuit City Stock were issued to or purchased on the open market for employees (450,698 shares in fiscal 1998 and 499,338 shares in fiscal 1997), and 268,532 shares of CarMax Stock were issued to or purchased on the open market on behalf of employees (92,775 in fiscal 1998). The average price per share of Circuit City Stock was $43.38 in fiscal 1999, $36.78 in fiscal 1998 and $32.68 in fiscal 1997. The average price per share of CarMax Stock was $7.56 in fiscal 1999 and $12.73 in fiscal 1998. The purchase price discount is charged to operations and totaled $2,984,500 in fiscal 1999, $2,670,400 in fiscal 1998 and $2,433,600 in fiscal 1997.

(E) STOCK INCENTIVE PLANS: Under the Company's stock incentive plans, incentive and nonqualified stock options may be granted to management, key employees and outside directors to purchase shares of Circuit City Stock or CarMax Stock. The exercise price for incentive stock options for employees and nonqualified options for outside directors is equal to, or greater than, the market value at the date of grant; for nonqualified options granted under the 1988 Plan for employees, it is at least 85 percent of the market value at the date of grant (100 percent under the 1994 Plan). Options generally are exercisable over a period of from one to 10 years from the date of grant. In fiscal 1998, options that were outstanding as of February 28, 1997, to purchase shares of stock of the corporate entity comprising the CarMax Group were converted into options to purchase CarMax Stock.

8. NET EARNINGS (LOSS) PER SHARE

Reconciliations of the numerator and denominator of basic and diluted net earnings (loss) per share are presented below:

(Amounts in thousands except per share data)	Years Ended February 28 1999	1998	1997
Circuit City Group:			
Weighted average common shares......................	99,152	98,027	97,311
Dilutive potential common shares:			
Options....................	850	842	889
Restricted stock...........	404	335	272
Weighted average common shares and dilutive potential common shares..............	100,406	99,204	98,472
Income available to common shareholders...............	$148,381	$112,074	$136,680
Basic net earnings per share...	$1.50	$1.14	$1.40
Diluted net earnings per share.	$1.48	$1.13	$1.39
CarMax Group:			
Weighted average common shares.....................	22,604	22,001	21,860
Loss available to common shareholders...............	$5,457	$7,763	$266
Net loss per share............	$0.24	$0.35	$0.01

Certain options were not included in the computation of diluted net earnings per share because the options' exercise prices were greater than the average market price of the common shares. Options to purchase 1,000,000 shares of Circuit City Stock at $59.00 per share were outstanding and not included in the calculation at the end of fiscal 1999; 1,510,000 shares ranging from $35.47 to $59.00 per share at the end of fiscal 1998; and 1,076,000 shares ranging from $32.25 to $59.00 per share at the end of fiscal 1997.

The CarMax Group had no diluted net loss per share because the Group had a net loss for the periods presented.

9. PENSION PLAN

The Company has a noncontributory defined benefit pension plan covering the majority of full-time employees who are at least age 21 and have completed one year of service. The cost of the program is being funded currently. Plan benefits generally are based on years of service and average compensation. Plan assets consist primarily of equity securities and included 80,000 shares of Circuit City Stock at February 28, 1999 and 1998. Contributions required were $10,306,000 in fiscal 1999, $11,642,000 in fiscal 1998 and $6,603,000 in fiscal 1997. The following tables set forth the Plan's financial status and amounts recognized in the consolidated balance sheets as of February 28:

(Amounts in thousands)	1999	1998
Change in benefit obligation:		
Benefit obligation at beginning of year..........	$89,124	$70,576
Service cost....................................	11,004	8,584
Interest cost...................................	6,202	5,260
Actuarial loss..................................	9,526	7,782
Benefits paid...................................	(3,290)	(3,078)
Benefit obligation at end of year...............	$112,566	$89,124
Change in plan assets:		
Fair value of plan assets at beginning of year...	$84,251	$62,928
Actual return on plan assets....................	4,411	12,759
Employer contributions..........................	10,306	11,642
Benefits paid...................................	(3,290)	(3,078)
Fair value of plan assets at end of year	$95,678	$84,251
Reconciliation of funded status:		
Funded status...................................	$(16,888)	$(4,873)
Unrecognized actuarial loss (gain)..............	9,720	(3,189)
Unrecognized transition asset...................	(606)	(808)
Unrecognized prior service benefit..............	(560)	(665)
Net amount recognized...........................	$(8,334)	$(9,535)

The components of net pension expense are as follows:

(Amounts in thousands)	Years Ended February 28 1999	1998	1997
Service cost......................	$11,004	$8,584	$9,389
Interest cost.....................	6,202	5,260	4,701
Expected return on plan assets....	(7,794)	(5,133)	(3,929)
Amortization of prior service cost	(105)	(105)	(105)
Amortization of transitional asset	(202)	(202)	(202)
Recognized actuarial loss.........	-	17	1,240
Net pension expense...............	$9,105	$8,421	$11,094

Assumptions used in the accounting for the pension plan were:

	Years Ended February 28 1999	1998	1997
Weighted average discount rate............	6.8%	7.0%	7.5%
Rate of increase in compensation levels...	5.0%	5.0%	5.5%
Expected rate of return on plan assets....	9.0%	9.0%	9.0%

10. LEASE COMMITMENTS

The Company conducts a substantial portion of its business in leased premises. The Company's lease obligations are based upon contractual minimum rates. For certain locations, amounts in excess of these minimum rates are payable based upon specified percentages of sales. Rental expense and sublease income for all operating leases are summarized as follows:

(Amounts in thousands)	Years Ended February 28 1999	1998	1997
Minimum rentals...............	$302,724	$248,383	$184,618
Rentals based on sales volume.	1,247	730	2,322
Sublease income...............	(20,875)	(12,879)	(11,121)
Net..........................	$283,096	$236,234	$175,819

The Company computes rent based on a percentage of sales volumes in excess of defined amounts in certain store locations. Most of the Company's other leases are fixed-dollar rental commitments, with many containing rent escalations based on the Consumer Price Index. Most provide that the Company pay taxes, maintenance, insurance and certain other operating expenses applicable to the premises.

Future minimum fixed lease obligations, excluding taxes, insurance and other costs payable directly by the Company, as of February 28, 1999, were:

(Amounts in thousands) Fiscal	Capital Leases	Operating Lease Commitments	Operating Sublease Income
2000........................	$1,662	$296,674	$(14,684)
2001........................	1,681	293,961	(12,817)
2002........................	1,725	289,553	(11,605)
2003........................	1,726	285,710	(10,624)
2004........................	1,768	283,422	(9,123)
After 2004..................	16,464	3,289,107	(55,144)
Total minimum lease payments.................	25,026	$4,738,427	$(113,997)
Less amounts representing interest.................	12,298		
Present value of net minimum capital lease payments [NOTE 5].........	$12,728		

In fiscal 1999, the Company entered into sale-leaseback transactions with unrelated parties at an aggregate selling price of $235,500,000 ($218,768,000 in fiscal 1998 and $201,694,000 in fiscal 1997). The Company does not have continuing involvement under the sale-leaseback transactions.

11. SUPPLEMENTARY FINANCIAL STATEMENT INFORMATION

Advertising expense, which is included in selling, general and administrative expenses in the accompanying consolidated statements of earnings, amounted to $467,661,000 (4.3 percent of net sales and operating revenues) in fiscal 1999, $400,346,000 (4.5 percent of net sales and operating revenues) in fiscal 1998 and $354,270,000 (4.6 percent of net sales and operating revenues) in fiscal 1997.

12. SECURITIZATIONS

(A) CREDIT CARD SECURITIZATIONS: The Company enters into securitization transactions, which allow for the sale of credit card receivables to unrelated entities, to finance the consumer revolving credit receivables generated by its wholly owned finance operation. Proceeds from securitization transactions were $224.6 million for fiscal 1999, $331.4 million for fiscal 1998 and $551.1 million for fiscal 1997.

Receivables relating to the securitization facilities consist of the following at February 28:

(Amounts in thousands)	1999	1998
Managed receivables..............	$2,957,132	$2,749,793
Receivables/residual interests held by the Company:		
For sale......................	(39,948)	(44,622)
For investment................	(161,996)	(203,921)
Net receivables sold............	$2,755,188	$2,501,250
Net receivables sold with recourse................	$322,000	$726,000
Program capacity................	$3,127,000	$3,075,000

Private-label credit card receivables are financed through securitization programs employing a master trust structure. As of February 28, 1999, this securitization program had a capacity of $1.38 billion. The agreement has no recourse provisions.

During fiscal 1998, a bank card master trust securitization facility was established and issued two series from the trust. Provisions under the master trust agreement provide recourse to the Company for any cash flow deficiencies on $322 million of the receivables sold. The finance charges from the transferred receivables are used to fund interest costs, charge-offs, servicing fees and other related costs. The Company believes that as of February 28, 1999, no liability existed under these recourse provisions. The bank card securitization program has a total program capacity of $1.75 billion.

The net gain on sales of receivables totaled $2.3 million for fiscal 1999, $21.8 million for fiscal 1998 and $3.2 million for fiscal 1997. The finance operation's servicing revenue, including gains on sales of receivables, totaled $200.6 million for fiscal 1999, $195.7 million for fiscal 1998 and $197.0 million for fiscal 1997. Rights recorded for future interest income from serviced assets that exceed the contractually specified servicing fees are carried at fair value and amounted to $27.3 million at February 28, 1999, $25.0 million at February 28, 1998, and $3.2 million at February 28, 1997, and are included in net accounts receivable. The servicing fees specified in the credit

card securitization agreements adequately compensate the finance operation for servicing the accounts. Accordingly, no servicing asset or liability has been recorded.

In determining the fair value of retained interests, the Company estimates future cash flows from finance charge collections, reduced by net defaults, servicing cost and interest cost. The Company employs a risk-based pricing strategy that increases the stated annual percentage rate for accounts that have a higher predicted risk of default. Accounts with a lower risk profile also may qualify for promotional financing.

The private-label card programs, excluding promotional balances, range from 21 percent to 24 percent APR, with default rates varying based on portfolio composition, but generally aggregating from 6 percent to 10 percent. Principal payment rates vary widely both seasonally and by credit terms but are in the range of 9 percent to 12 percent.

The bank card APRs are based on the prime rate and generally range from 7 percent to 22 percent, with default rates varying by portfolio composition, but generally aggregating from 8 percent to 12 percent. Principal payment rates vary widely both seasonally and by credit terms but are in the range of 5 percent to 8 percent.

Interest cost paid by the master trusts varies between series and ranges from 5.0 percent to 6.3 percent.

(B) AUTOMOBILE LOAN SECURITIZATION: In fiscal 1996, the Company entered into a securitization agreement to finance the consumer installment credit receivables generated by its automobile loan finance operation. Proceeds from the automobile loan securitization transaction were $271 million during fiscal 1999, $123 million during fiscal 1998 and $58 million during fiscal 1997.

Receivables relating to the securitization facility consist of the following at February 28:

(Amounts in thousands)	1999	1998
Managed receivables..................	$589,032	$291,294
Receivables held by the Company:		
For sale..........................	(14,690)	(5,816)
For investment*...................	(35,342)	(17,478)
Net receivables sold................	$539,000	$268,000
Program capacity....................	$575,000	$300,000

*Held by a bankruptcy remote special purpose company

The finance charges from the transferred receivables are used to fund interest costs, charge-offs and servicing fees. A restructuring of the facility during fiscal 1997 resulted in the recourse provisions being eliminated.

The net gain on sales of receivables totaled $7.9 million for fiscal 1999, $3.7 million for fiscal 1998 and $3.1 million for fiscal 1997. Rights recorded for future interest income from serviced assets that exceed the contractually specified servicing fees are carried at fair value and amounted to $14.7 million at February 28, 1999, $6.8 million at February 28, 1998, and $3.1 million at February 28, 1997, and are included in net accounts receivable. The finance operation's servicing revenue, including gains on sales of receivables, totaled $28.2 million for fiscal 1999, $11.2 million for fiscal 1998 and $8.7 million for fiscal 1997. The servicing fee specified in the auto loan securitization agreement adequately compensates the finance operation for servicing the accounts. Accordingly, no servicing asset or liability has been recorded.

In determining the fair value of retained interests, the Company estimates future cash flows from finance charge collections, reduced by net defaults, servicing cost and interest cost. The Company employs a risk-based pricing strategy that increases the stated APR for accounts that have a higher predicted risk of default. Accounts with a lower risk profile also may qualify for promotional financing.

The APRs range from 6 percent to 12 percent fixed, with default rates varying based on credit quality, but generally aggregating 0.75 percent to 1.25 percent. Weighted average life of the receivables is expected to be in the 18 month to 20 month range.

Interest cost depends on the time at which accounts were originated, but is in the range of 5 percent to 7 percent.

13. INTEREST RATE SWAPS

In October 1994, the Company entered into five-year interest rate swap agreements with notional amounts totaling $300 million relating to a public issuance of securities by the master trust. As part of this issuance, $344 million of five-year, fixed-rate certificates were issued to fund consumer credit receivables. The credit card finance operation is servicer for the accounts, and as such, receives its monthly cash portfolio yield after deducting interest, charge-offs and other related costs. The underlying receivables are based on a floating rate. The swaps were put in place to better match funding costs to the receivables being securitized. As a result, the master trust pays fixed-rate interest, and the Company utilizes the swaps to convert the fixed-rate obligation to a floating-rate, LIBOR-based obligation. These swaps were entered into as part of the sales of receivables and are included in the gain on sales of receivables.

Concurrent with the funding of the $175 million term loan facility in May 1995, the Company entered into five-year interest rate swaps with notional amounts aggregating $175 million. These swaps effectively converted the variable-rate obligation into a fixed-rate obligation. The fair value of the swaps is the amount at which they could be settled. This value is based on estimates obtained from the counterparties, which are two banks highly rated by several financial rating agencies. The swaps are held for hedging purposes and are not recorded at fair value. Recording the swaps at fair value at February 28, 1999, would result in a loss of $2.2 million and at February 28, 1998, would result in a loss of $1.9 million.

The Company enters into amortizing swaps relating to the auto loan receivable securitization to convert variable-rate financing costs to fixed-rate obligations to better match funding costs to the receivables being securitized. In November 1995, the Company entered into a 50-month amortizing swap with a notional amount of $75 million and, in October 1996, entered into a 40-month amortizing swap with a notional amount of $64 million. The Company entered into four 40-month amortizing swaps with notional amounts totaling approximately $162 million during fiscal 1998 and four 40-month amortizing swaps with notional amounts totaling approximately $387 million in fiscal 1999. These swaps were entered into as part of sales of receivables and are included in the gain on sales of receivables. The remaining total notional amount of all swaps related to the auto loan receivable securitization was approximately $499 million at February 28, 1999, $224 million at February 28, 1998, and $114 million at February 28, 1997.

The market and credit risks associated with these interest rate swaps are similar to those relating to other types of financial instruments. Market risk is the exposure created by potential fluctuations in interest rates and is directly related to the product type, agreement terms and transaction volume. The Company does not anticipate significant market risk from swaps, since their use is to more closely match funding costs to the use of the funding. Credit risk is the exposure to nonperformance of another party to an agreement. The Company mitigates credit risk by dealing with highly rated counterparties.

14. COMMITMENTS AND CONTINGENT LIABILITIES

(A) INVESTMENT IN DIVX: In May 1995, the Company agreed to invest $30.0 million in Divx, a partnership that has developed and is marketing a new home digital video system. That commitment was increased to $130.0 million in September 1997. Although that commitment was fulfilled during fiscal 1999, the Company continues to fund the operations of Divx as management continues to explore various financing options. As of February 28, 1999, the Company owned approximately 75 percent of the partnership. The Company has been allocated 100 percent of the losses since inception. The Company allocates its investment in Divx to the Circuit City Group. As of February 28, 1999, the Company had funded approximately $207 million for the operations of Divx.

(B) LICENSING AGREEMENTS: Divx has entered into licensing agreements with motion picture distributors for use of their feature-length films for the Divx system. The Company guarantees Divx's performance under these commitments. The licensing fees are based on varying percentages of consumer viewing and wholesale receipts and require minimum distributor compensation commencing from the operational date of each agreement through the following one to five years. As of February 28, 1999, the minimum compensation due from Divx to the distributors is $101.0 million ($26.0 million in fiscal 2000, $32.0 million in fiscal 2001, $20.5 million in fiscal 2002, $14.5 million in fiscal 2003 and $8.0 million in fiscal 2004).

(C) LEGAL PROCEEDINGS: In the normal course of business, the Company is involved in various legal proceedings. Based upon the Company's evaluation of the information presently available, management believes that the ultimate resolution of any such proceedings will not have a material adverse effect on the Company's financial position, liquidity or results of operations.

15. OPERATING SEGMENT INFORMATION The Company conducts business in three operating segments: Circuit City, Divx and CarMax. These segments are identified and managed by the Company based on the different products and services offered by each. Circuit City refers to the retail operations bearing the Circuit City name and to all related operations such as its finance operation. This segment is engaged in the business of selling brand-name consumer electronics, personal computers, major appliances and entertainment software. Divx primarily is engaged in the business of selling specially encrypted DVD at wholesale. CarMax refers to the used- and new-car retail locations bearing the CarMax name and to all related operations such as its finance operation. Financial information for these segments for fiscal 1999, 1998 and 1997 are shown in Table 3.

1999 (Amounts in thousands)	Circuit City	Divx	CarMax	Elimination	Total Segments
Revenues from external customers........................	$9,335,298	$2,851	$1,466,298	$-	$10,804,447
Intersegment revenues..................................	8,872	6,830	-	(15,702)	-
Interest expense.......................................	21,926	-	6,393	-	28,319
Depreciation and amortization..........................	119,724	10,566	10,003	-	140,293
Earnings (loss) before income taxes....................	379,630	(110,558)	(38,549)	-	230,523
Provision for income taxes (income tax benefit)..........	144,646	(42,012)	(15,035)	-	87,599
Net earnings (loss)....................................	234,984	(68,546)	(23,514)	-	142,924
Total assets...	$2,813,635	$60,433	$571,198	$-	$3,445,266

1998 (Amounts in thousands)	Circuit City	Divx	CarMax	Elimination	Total Segments
Revenues from external customers........................	$7,996,591	$-	$874,206	$-	$8,870,797
Interest expense.......................................	25,072	-	1,789	-	26,861
Depreciation and amortization..........................	110,282	1,467	4,577	-	116,326
Earnings (loss) before income taxes....................	257,632	(33,284)	(56,104)	-	168,244
Provision for income taxes (income tax benefit)..........	98,462	(12,648)	(21,881)	-	63,933
Net earnings (loss)....................................	159,170	(20,636)	(34,223)	-	104,311
Total assets...	$2,752,402	$30,977	$448,322	$-	$3,231,701

1997 (Amounts in thousands)	Circuit City	Divx	CarMax	Elimination	Total Segments
Revenues from external customers........................	$7,153,562	$-	$510,249	$-	$7,663,811
Interest expense.......................................	23,503	-	6,279	-	29,782
Depreciation and amortization..........................	97,006	307	1,664	-	98,977
Earnings (loss) before income taxes....................	248,567	(12,614)	(15,929)	-	220,024
Provision for income taxes (income tax benefit)..........	95,014	(4,793)	(6,611)	-	83,610
Net earnings (loss)....................................	153,553	(7,821)	(9,318)	-	136,414
Total assets...	$2,699,907	$4,692	$427,187	$(50,613)	$3,081,173

16. QUARTERLY FINANCIAL DATA (UNAUDITED)

(Amounts in thousands except per share data)	First Quarter 1999	First Quarter 1998	Second Quarter 1999	Second Quarter 1998	Third Quarter 1999	Third Quarter 1998	Fourth Quarter 1999	Fourth Quarter 1998	Year 1999	Year 1998
Net sales and operating revenues..........	$2,271,090	$1,856,904	$2,517,154	$2,020,572	$2,612,896	$2,144,219	$3,403,307	$2,849,102	$10,804,447	$8,870,797
Gross profit.........	$504,514	$418,278	$571,672	$472,429	$592,105	$481,753	$776,728	$671,204	$2,445,019	$2,043,664
Net earnings (loss) attributed to:										
Circuit City Stock	$13,269	$12,749	$32,147	$27,879	$15,945	$14,012	$87,020	$57,434	$148,381	$112,074
CarMax Stock......	$(736)	$(275)	$(685)	$(393)	$(1,701)	$(2,075)	$(2,335)	$(5,020)	$(5,457)	$(7,763)
Net earnings (loss) per share:										
Circuit City Stock:										
Basic..........	$0.13	$0.13	$0.32	$0.28	$0.16	$0.14	$0.87	$0.58	$1.50	$1.14
Diluted........	$0.13	$0.13	$0.32	$0.28	$0.16	$0.14	$0.86	$0.58	$1.48	$1.13
CarMax Stock......	$(0.03)	$(0.01)	$(0.03)	$(0.02)	$(0.07)	$(0.09)	$(0.10)	$(0.23)	$(0.24)	$(0.35)

INDEPENDENT AUDITORS' REPORT

The Board of Directors and Stockholders
of Circuit City Stores, Inc.:

We have audited the accompanying consolidated balance sheets of Circuit City Stores, Inc. and subsidiaries as of February 28, 1999 and 1998 and the related consolidated statements of earnings, stockholders' equity and cash flows for each of the fiscal years in the three-year period ended February 28, 1999. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Circuit City Stores, Inc. and subsidiaries as of February 28, 1999 and 1998 and the results of their operations and their cash flows for each of the fiscal years in the three-year period ended February 28, 1999 in conformity with generally accepted accounting principles.

/s/KPMG LLP
Richmond, Virginia
April 2, 1999

RESULTS OF OPERATIONS

Sales Growth

Total sales for the Circuit City Group increased 17 percent in fiscal 1999 to $9.34 billion. In fiscal 1998, total sales were $8.00 billion, a 12 percent increase from $7.15 billion in fiscal 1997.

PERCENTAGE SALES CHANGE FROM PRIOR YEAR

	Circuit City Group		
Fiscal	Total	Comparable	Industry*
1999	17%	8 %	5 %
1998	12%	(1)%	(3)%
1997	6%	(8)%	(8)%
1996	23%	5 %	6 %
1995	34%	15 %	11 %

* The industry sales rates are derived from Electronic Industries Alliance, Recording Industry Association of America and Company estimates of audio, video, home office, telecommunications, appliance and music software sales.

The fiscal 1999 total sales increase reflects an 8 percent comparable store sales increase, which was in part caused by an acceleration in industry growth, and the continued geographic expansion of the Group's Circuit City Superstores. In fiscal 1999, the Group opened 37 Superstores. The Group entered a number of one- and two-store markets; added stores to existing markets, including the New York metropolitan market that was entered in fiscal 1998; replaced three Superstores; and closed two consumer electronics-only stores. In addition, the Group remodeled 30 stores to reflect its most recent merchandising initiatives.

The Group operates four Circuit City Superstore formats with square footage and merchandise assortments tailored to volume expectations for specific trade areas. The "D" format serves the most populous trade areas. At the end of fiscal 1999, selling space for the "D" format stores averaged about 23,000 square feet and total square footage for all "D" stores averaged 43,042. The "C" format constitutes the largest percentage of the store base. At the end of fiscal 1999, selling space in the "C" format stores averaged about 15,000 square feet with total square footage for all "C" stores averaging 34,036. The "B" format often is located in smaller markets or in smaller trade areas within larger metropolitan markets. At the end of fiscal 1999, selling space in these stores averaged approximately 12,500 square feet with an average total square footage of 26,651. The "B" stores offer a broad merchandise assortment that maximizes return on investment in lower volume areas. The "A" format serves the least populated trade areas. Selling space for all "A" stores averaged approximately 9,500 square feet at the end of fiscal 1999, and total square footage averaged 19,558. These stores feature a layout, staffing level and merchandise assortment that creates high productivity in the smallest markets.

The Group also operates 48 mall-based Circuit City Express stores. These stores are located in regional malls and are approximately 2,000 to 3,000 square feet in size.

STORE MIX

Fiscal	1999	1998	1997	1996	1995
	Retail Units at Year-End				
Superstore					
"D" Superstore........	118	114	95	61	12
"C" Superstore........	294	289	278	259	257
"B" Superstore........	82	72	54	46	37
"A" Superstore........	43	25	16	12	6
Electronics-Only.........	2	4	5	5	5
Circuit City Express.....	48	52	45	36	35
Total....................	587	556	493	419	352

Industry sales in Circuit City's retail segments have varied significantly over the past five years, resulting in wide variations in the Group's sales growth. Geographic expansion and the addition of product categories such as personal computers were the primary contributors to the Circuit City Group's total sales growth early in the period. From mid-fiscal 1996 through fiscal 1998, a lack of significant product introductions resulted in lower average retails and weak sales throughout the industry. In fiscal 1999, the industry began to emerge from this period of declining sales. For Circuit City, the fiscal 1999 sales reflected strong sales across all major categories with especially strong sales in personal computers and in new high technology areas such as DIRECTV; wireless communications; DVD players, especially players with the Divx feature; and digital camcorders. The continued Superstore additions also contributed to the total sales growth.

The industry weakness in fiscal 1997 and 1998 resulted in a highly competitive climate, and a significant number of regional competitors closed stores. Despite the improvement in fiscal1999, the consumer electronics industry remains highly competitive. Circuit City's primary competitors are large specialty, discount or warehouse retailers with generally lower levels of service. Because of Circuit City's long history of providing exceptional customer service, management believes that the Circuit City locations can continue to maintain share in existing markets and build comparable shares in new markets.

SALES BY MERCHANDISE CATEGORIES

Fiscal	1999	1998	1997	1996	1995
TV....................	18%	18%	18%	17%	19%
VCR/Camcorders........	13%	13%	14%	13%	14%
Audio.................	16%	17%	18%	19%	22%
Home Office...........	27%	25%	24%	26%	20%
Appliance.............	15%	15%	15%	14%	15%
Other.................	11%	12%	11%	11%	10%
Total.................	100%	100%	100%	100%	100%

The Group sells two extended warranty programs on behalf of unrelated third parties that issue these plans for merchandise sold by the Group and other retailers. These third-party programs are sold in most major markets. In states where third-party warranty sales are not permitted, the Group sells a Circuit City extended warranty. Gross dollar sales from all extended warranty programs were 5.4 percent of the Group's total sales in fiscal year 1999, compared with 5.5 percent in fiscal 1998 and 6.0 percent in fiscal 1997. The lower percentages in fiscal years 1999 and 1998 reflect the impact of lower average retail prices on consumer demand for the related warranties in many categories and increased sales of some products that carry lower warranty penetration rates. Total extended warranty revenue, which is reported in the Group's total sales, was 4.6 percent of sales in fiscal years 1999 and 1998 and 5.1 percent of sales in fiscal year 1997. The gross profit margins on products sold with extended warranties are higher than the gross profit margins on products sold without extended warranties. Third-party extended warranty revenue was 4.1 percent of the Group's total sales in fiscal year 1999 and 3.6 percent of the Group's total sales in fiscal years 1998 and 1997. The fiscal 1999 increase in third-party extended warranty revenue reflects the conversion of stores in 10 states to third-party warranty sales in June 1998.

SUPERSTORE SALES PER TOTAL SQUARE FOOT

Fiscal	
1999	$514
1998	$478
1997	$499
1996	$577
1995	$584

SUPERSTORE SALES PER TOTAL SQUARE FOOT. Over the last five years, the Group has significantly increased the percentage of store square footage devoted to selling space. In fiscal 1995, the Group introduced the larger format "D" stores in some markets. These stores are intended to generate high sales volumes in specific trade areas but lower sales per total square foot than smaller Superstores. These stores and the declines in comparable store sales produced lower Superstore sales per total square foot in the period from fiscal 1996 through fiscal 1998. The fiscal 1999 sales per square foot increase primarily reflects the comparable store sales increase.

IMPACT OF INFLATION. Inflation has not been a significant contributor to the Group's results. In fact, during the past two years, the average retail price has declined in virtually all of the Group's product categories. Although new product introductions could help reverse this trend in selected areas, management expects no significant short-term change overall. Because the Group purchases substantially all products in U.S. dollars, prices are not directly impacted by the value of the dollar in relation to other foreign currencies, including the Japanese yen.

Digital Video Express

Digital Video Express has developed and is marketing a new digital video system for watching movies at home. Circuit City Stores, Inc. holds the majority interest in the business. The remaining interest is held by the prominent Los Angeles law firm Ziffren, Brittenham, Branca & Fischer. The Company's investment in Divx is allocated to the Circuit City Group. Through the end of fiscal 1999, the Company had invested $207 million in Divx, $120 million of which was invested in fiscal 1999. The investment in Divx impacts the Circuit City Group's gross profit margin and selling, general and administrative expense ratio.

Cost of Sales, Buying and Warehousing

The gross profit margin was 24.3 percent of sales in fiscal 1999, 24.6 percent in fiscal 1998 and 24.0 percent in fiscal 1997. The lower gross margin in fiscal 1999 reflects the strength of the personal computer business, which carries lower gross margins; the continued highly competitive price environment for the Circuit City business; and costs associated with Divx. Better inventory management and increased sales of new technologies and more fully featured products partly offset these factors. The Group gradually has reduced its assortment in a variety of product categories to more closely match consumer demand and has carefully managed product transitions, especially in the personal computer business. As a result, mark-downs have decreased, reducing their impact on the gross margin. Excluding Divx, the gross margin for the Circuit City business was 24.4 percent of sales in fiscal 1999. Because Divx was not selling any product in fiscal 1998 and fiscal 1997, it had no impact on gross margins in those periods.

Selling, General and Administrative Expenses

Selling, general and administrative expenses were 21.2 percent of sales in fiscal 1999 compared with 21.5 percent in fiscal 1998 and 20.4 percent in fiscal 1997. The improved ratio in fiscal 1999 primarily reflects the expense leverage gained from the comparable store sales increase, partly offset by selling, general and administrative expenses related to Divx. Operating profits generated by the Group's finance operation are recorded as a reduction to the selling, general and administrative expenses. Excluding Divx, the expense ratio for the Circuit City business was 20.1 percent in fiscal 1999, 21.1 percent in fiscal 1998 and 20.2 percent in fiscal 1997.

Interest Expense

Interest expense was 0.2 percent of sales in fiscal 1999 and 0.3 percent of sales in fiscal 1998 and 1997. Interest expense was incurred on allocated debt used to fund store expansion, working capital and the nvestment in Divx.

Income Taxes

The Group's effective income tax rate was 38.1 percent in fiscal year 1999, 38.3 percent in fiscal year 1998 and 38.2 percent in fiscal 1997. The shifts in the tax rate reflect the state tax impact of variations in taxable income produced by the Group's separate legal operating entities.

Earnings before the Inter-Group Interest in the CarMax Group

Earnings before the Inter-Group Interest in the CarMax Group increased 20 percent to $166.4 million in fiscal 1999. In fiscal 1998, earnings before the Inter-Group Interest in the CarMax Group were $138.5 million, a 5 percent decrease from $145.7 million in fiscal 1997. The results for all three years include the Company's investment in Digital Video Express. Excluding the Company's investment in Divx, earnings for the Circuit City Group before the Inter-Group Interest in the CarMax Group increased 48 percent to $235.0 million in fiscal 1999 compared with $159.2 million in fiscal 1998 and $153.6 million in fiscal 1997.

Net Loss Related to the Inter-Group Interest in the CarMax Group

The CarMax Group has incurred losses since its startup in fiscal 1994. The net loss attributed to the Circuit City Group's Inter-Group Interest in the CarMax Group was $18.1 million in fiscal 1999, $26.5 million in fiscal 1998 and $9.1 million in fiscal 1997.

Net Earnings

Net earnings for the Circuit City Group were $148.4 million in fiscal 1999, $112.1 million in fiscal 1998 and $136.7 million in fiscal 1997. Net earnings per share were $1.48 in fiscal 1999, $1.13 in fiscal 1998 and $1.39 in fiscal 1997. The improved results in fiscal 1999 primarily reflect the renewed strength in the Company's Circuit City business, which was partly offset by the increased investment in Divx and the losses incurred by the CarMax Group. The lower earnings in fiscal year 1998 compared with fiscal year 1997 reflect the challenging industry environment faced by the Circuit City business at that time, the Company's higher investment in Digital Video Express and increased losses incurred by the CarMax Group.

Operations Outlook

Management expects that industry growth will be the primary contributor to sales and earnings growth for the Circuit City business during the coming decade. Management anticipates that growth in the household penetration of products such as DIRECTV, wireless communications, digital camcorders, DVD players and personal computers will be the major contributors to this growth. Management also believes that the introductions of digital and high-definition televisions and multi-functional set top boxes will help drive industry sales to new levels. Management expects to focus its attention on maximizing store volumes in the existing Circuit City Superstores. These efforts will include the remodeling of approximately 50 Superstores in fiscal 2000 to include the Group's new merchandising initiatives.

Circuit City has established its presence in virtually all of the nation's top 100 markets and will continue adding to the existing store base as attractive market opportunities arise. Management believes that the Group has the opportunity to operate approximately 800 Superstores within the United States. In fiscal 2000, the Group will continue to expand its Superstore concept into new trade areas, adding approximately 35 stores that are either new-market entries or fill-in locations in existing Circuit City markets, including approximately seven additional stores in the New York metropolitan area. Management anticipates that the industry's growth, ongoing expansion and continued strong operating controls will enable the Circuit City business to generate earnings growth of 20 percent to 25 percent in fiscal 2000.

Management continues to be encouraged by the long-term profit potential of the Company's investment in Digital Video Express. The early sales results exceeded management's expectations, as DVD players with the Divx feature captured a 20 percent to 25 percent share of DVD player sales during the last quarter of the fiscal year. Titles are available from major studios. Divx expects eight player brands to be available in calendar 1999. At February 28, 1999, approximately 370 titles were available on Divx discs and Divx plans to add 30 to 40 titles each month in fiscal 2000. Management remains in active discussions with potential financing and distribution partners for Divx and is optimistic that the Company will complete one or more transactions in fiscal 2000. However, in the event that additional financing is not obtained, management does not expect the costs associated with Divx in fiscal 2000 to exceed those incurred in fiscal 1999.

Management expects that CarMax's financial performance will improve to a modest loss or to break-even in fiscal 2000. The CarMax results will be partly reflected in the Circuit City Group's Inter-Group Interest.

BEST BUY

Best Buy Co. [BBY] is the nation's largest volume specialty retailer of name brand consumer electronics, home office equipment, entertainment software and appliances. The Company started in 1966 as an audio component systems retailer, and in the early 1980s, with the introduction of the video cassette recorder, expanded into video products. In 1983, the Company changed its marketing strategy to use mass merchandising techniques for a wider variety of products, and began to operate its stores with a "superstore" format. In 1989, Best Buy dramatically changed its method ofretailing by introducing its Concept II store format, a self-service, non-commissioned, discount style sales environment designed to give the customer more control over the purchasing process. The Company determined that an increasing number of customers had become knowledgeable enough to select products without the assistance of a commissioned salesperson and preferred to make purchases in a more convenient and customer friendly environment.

In fiscal 1995, the Company developed a strategy to further enhance its store format. The strategy, known as Concept III, incorporates a larger store format created to produce a more informative and exciting shopping experience for the customer. Through focus group interviews and other research, the Company determined that customers wanted more product information and a larger product selection. In order to meet these evolving consumer preferences, the Company developed an enhanced store format which features more hands-on and interactive product demonstrations. In fiscal 1999, the Company introduced its Concept IV store format. This new format features improved merchandising, signage and customer service and is expected to better address consumers' needs as the consumer electronics industry, in particular, progresses into new digital products. Concept IV reinforces the Company's retailing strategy as the destination for new technology in a fun, informative and no pressure shopping environment. With its innovative retail format, the Company has moved into a leading position nationally in all of its principal product categories except appliances, where it ranks third.

In fiscal 1999, the Company increased its store count by 10%, with the addition of 28 new stores and, as of February 27, 1999, was operating 311 stores in 36 states. The Company accelerated its expansion in fiscal 1999 after initiatives to improve operations resulted in an enhanced operating model. The Company anticipates opening approximately 45 stores in fiscal 2000, and expects to be operating 356 stores by the end of fiscal 2000.

Business Strategy

The Company's business strategy is to offer consumers an enjoyable and convenient shopping experience while maximizing the Company's profitability. Best Buy believes it offers consumers meaningful advantages in store environment, product value, selection and service. An objective of this strategy has been to achieve a dominant market share in the markets Best Buy serves. The Company currently holds a leading, and in some cases dominant, share in its mature markets. The Company's store format features interactive displays, and for certain product categories, a high level of customer assistance, all designed to enhance the customer's shopping experience. As part of its overall strategy, the Company:

- Generally offers a retail format similar to a self service discount store for many products that consumers are familiar with and provides a higher level of customer service and product explanation for more technically complex and integrated products.

- Provides a selection of brand name products comparable to retailers that specialize in the Company's principal product categories and seeks to ensure a high level of product availability for customers.

- Seeks to provide customers with the best product value available in the market area through active comparison shopping programs, daily price changes, lowest price guarantees and special promotions, including interest-free financing, performance service plans generally priced below competitors, and home delivery.

- Provides a variety of services not offered by certain competitors, including convenient financing programs, product delivery and installation and post-sale services including repair and warranty services and computer upgrades.

- Locates stores at sites that are easily accessible from major highways and thoroughfares and seeks to create sufficient concentrations of stores in major markets to maximize the leverage on fixed costs including advertising and operations management.

- Controls costs and enhances operating efficiency by centrally controlling all buying, merchandising and distribution, and vertically integrating certain support functions such as advertising.

Best Buy's store format is a key component of its business strategy. The Company believes that because customers are generally familiar with certain products the Company sells and are accustomed to discount shopping formats, they increasingly resist efforts to direct their choice of product and appreciate controlling the purchase decision. For products that are relatively easy for consumers to understand and purchase, the Company employs a self-service, discount style store format, featuring easy to locate product groupings, emphasizing customer choice and product information. These products include entertainment software and less complex consumer electronics products such as boom boxes, VCRs and smaller sized television sets. For other, more complex products such as personal computers, digital versatile disc (DVD), digital phones and digital cameras, the Company provides dedicated and specially trained sales assistance. Sales staff in these product categories help customers understand the features and benefits of new technology and can assist customers in the purchase of accessories and registration for service with providers.

Best Buy continuously evaluates the retail environment and regularly uses focus groups and customer surveys to assess customer preferences. Through these processes, Best Buy concluded that customers want access to more product information in order to be more confident about their buying decisions. Most stores contain a demonstration area for home theater systems; a simulated, life-size car display; and audio speaker areas. These demonstration areas allow customers to experience and compare product performance firsthand. Most of the stores also feature a "high touch" sales area where specially trained salespeople assist customers with more complex products such as digital cameras, digital phones and personal digital assistants. Best Buy believes that these demonstration and display areas further differentiate it from competing retailers and should also provide an advantage for the Company relative to competitors such as catalog and Internet retailers. Most Best Buy stores feature a configure to order process for personal computers that enables more knowledgeable computer buyers to tailor order a computer system.

The Company also sells music software and DVD videos on its E-commerce site, www.bestbuy.com. While E-commerce does not currently represent a significant portion of the Company's business, the Company believes expansion of its on-line sales initiative represents a significant growth opportunity and in April 1999 named a president of its E-commerce Division to lead the continued development and expansion of the Company's Internet initiative. The Company plans to introduce other products in its principal product categories on its E-commerce site in the coming year. Management believes that its retail stores and E-commerce strategy should complement each other, allowing consumers to purchase products in the shopping environment they prefer. The Company believes that its marketplace visibility and significant size in the retailing of its products should provide a competitive advantage over other Internet retailers. The Company's existing name recognition and weekly print and television advertising are examples of some of the efficiencies the Company has over new entrants in E-commerce. Additionally, the ability to provide convenient product service and repair creates an opportunity to differentiate the Company from other Internet retailers.

The Company's stores are in large, open buildings with high ceilings. Best Buy's stores average approximately 44,000 square feet. The stores feature interactive displays and skilled employee demonstrations; most stores feature large viewing areas for big screen and projection televisions and interactive speaker environments. The Company expects to open approximately 45 new stores in fiscal 2000, including the testing of four 30,000 square foot stores designed for smaller markets with populations up to 200,000.

Best Buy's merchandising strategy differs from many other retailers selling comparable merchandise. Best Buy's merchandise is displayed at eye level next to signs identifying the products' major features, with the boxed products available near the display model. The Company's product specialists, who are knowledgeable about the operation and features of the merchandise on display, are dedicated to a particular product area for customers who desire assistance.

This convenient, self service format for many of the products the Company sells allows the customer to carry merchandise directly to the check-out lanes, pay for it and leave the store, avoiding the time-consuming process used at traditional superstores.

The Company believes that its advertising strategy continues to contribute to its increasing market share and brand image. Best Buy spends almost 3% of store sales on advertising, including the weekly distribution of about 36 million newspaper inserts. The Company has vertically integrated advertising and promotion capabilities and operates its own in-house advertising agency. This capability allows the Company to respond rapidly to competitors in a cost effective manner. In many of its markets, the Company is able to secure and deliver merchandise to its stores and to create, produce and run an advertisement all within a period of less than one week.

Print advertising generally consists of four-color weekly inserts, generally 24 to 28 pages, that emphasize a variety of product categories and feature extensive name brand selection with a wide range of price points. The Company also produces all of its television commercials, each with a specific marketing message. Television commercials account for about one-third of total advertising expenditures. The Company also utilizes a national brand image program to move Best Buy's image beyond that of a low price specialty retailer by promoting the customer's shopping experience and the Company's responsiveness to consumers' needs. The Company believes that building customer brand loyalty is a significant element in its business strategy. The Company is reimbursed by vendors for a substantial portion of advertising expenditures through cooperative advertising arrangements

Product service and repair are important aspects of Best Buy's marketing strategy, providing the opportunity to differentiate itself from warehouse clubs, other discount stores, and Internet retailers which generally do not provide such services. Virtually all products sold by the Company, with the exception of entertainment software, carry manufacturers' warranties. The Company generally offers to service and repair all of the products it sells and has been designated by substantially all of its major suppliers as an authorized service center. In addition, the Company makes its in-store technical support staff available to assist customers with the custom configuration of personal computers and peripheral products. The Company also delivers major appliances and large electronics products and installs car stereos and vehicle security systems. In fiscal 2000, the Company is dedicating significant resources to expanding and improving its services capabilities. The Company is undertaking efforts to reduce product repair times and increase its product installation capabilities in customers' homes.

Management Discussion

Gross profit margin was 18.1% of sales in fiscal 1999, an improvement of 2.2% of sales from fiscal 1998. This increase was mainly due to the impact from initiatives to generate a more profitable product assortment, faster turning inventory and increased advertising effectiveness. For the second consecutive year, inventory turns increased by one full turn, to 6.6 turns in fiscal 1999 compared to 5.6 turns in fiscal 1998 and 4.6 turns in fiscal 1997. This increase in inventory turns resulted in fewer markdowns, particularly during product model transitions. The increase in sales of higher margin PSPs also contributed to the improvement in gross profit margin. Another factor in the gross profit margin improvement was lower inventory shrink as a result of better execution at the retail stores. The Company anticipates further improvement in the gross profit margin rate in fiscal 2000 as it continues to realize benefits from its strategic initiatives, although the rate of gross profit margin improvement will be less than the significant increases in the past two years.

Gross profit margin of 15.9% in fiscal 1998 improved from 13.6% in fiscal 1997, a gain that was driven by greatly improved inventory management, particularly in the personal computer product category. A less promotionally driven sales environment, lower inventory shrink and an increase in sales of PSPs also contributed to the gross margin improvement.

Selling, general and administrative expenses (SG&A) increased to 14.5% of sales in fiscal 1999 compared to 13.7% of sales in fiscal 1998, primarily as a result of higher payroll-related expenses and an increase in professional services. The increase in payroll-related expenses was primarily due to an increase in overall financial performance-based compensation, higher levels of compensation resulting from building a higher caliber staff at the retail stores and labor market conditions. Additionally, a full year operation of the retail stores' "high touch" area and expenses associated with an increased number of store openings contributed to higher personnel costs. Professional services costs increased due to the Company's initiatives to improve operating performance and implement business process improvements. The Company also increased its spending on outside consultants to help improve technical services operations and enhance management training and development. The Company's spending on Year 2000 system issues also increased in fiscal 1999. Management believes that the investment in strategic initiatives has improved the Company's operating model and has resulted in the gross profit margin gains. The returns from the increased investment in SG&A are reflected in the improvement in operating income to 3.6% of sales in fiscal 1999 from 2.2% in fiscal 1998.

SG&A is anticipated to increase in fiscal 2000 as the Company continues to invest in new information systems, operational improvements, technical services enhancements and its E-commerce initiative. The outside consultants that had been assisting the Company with its retail and marketing initiatives over the past three years have been engaged in a multi-year project to improve the operations and financial performance of the Company's service division. Management expects the additional investment in SG&A will be adequately funded by the anticipated increase in gross profit margin.

The increase in the SG&A ratio in fiscal 1998 compared to fiscal 1997 also was due primarily to higher levels of compensation and professional services. Compensation increased due to a tight labor market and the introduction of the dedicated staff in the "high touch" area of the stores. Professional service expenses were incurred to improve marketing effectiveness and retail operations, in addition to addressing Year 2000 system issues.

Net interest improved by $33 million in fiscal 1999 as compared to fiscal 1998, in part due to the conversion of the Company's $230 million in preferred securities into equity in the first quarter of fiscal 1999. Improvements in inventory management and strong sales enabled the Company to build significant cash balances and prepay its $150 million 8-5/8% Senior Subordinated Notes in October 1998. The prepayment premium of $3.8 million and the write-off of the remaining deferred debt offering costs of approximately $1.1 million are included in interest expense. The conversion and retirement of these two long-term financings reduces interest expense by about $28 million annually. In addition, the higher cash balances generated increased interest income.

CONSOLIDATED BALANCE SHEETS

$ IN THOUSANDS, EXCEPT PER SHARE AMOUNTS

ASSETS	FEB. 27 1999	FEB. 28 1998
CURRENT ASSETS		
Cash and cash equivalents	$ 785,777	$ 520,127
Receivables	132,401	95,702
Recoverable costs from developed properties	73,956	8,215
Merchandise inventories	1,046,366	1,060,788
Other current assets	24,591	25,445
Total current assets	2,063,091	1,710,277
PROPERTY AND EQUIPMENT		
Land and buildings	23,158	19,977
Leasehold improvements	174,495	160,202
Furniture, fixtures and equipment	505,232	372,314
Property under capital leases	29,079	29,079
	731,964	581,572
Less accumulated depreciation and amortization	308,324	248,648
Net property and equipment	423,640	332,924
OTHER ASSETS	25,762	13,145
TOTAL ASSETS	$2,512,493	$2,056,346

LIABILITIES AND SHAREHOLDERS' EQUITY	FEB. 27 1999	FEB. 28 1998
CURRENT LIABILITIES		
Accounts payable	$1,011,746	$ 762,652
Accrued compensation and related expenses	86,667	48,772
Accrued liabilities	211,555	182,719
Income taxes payable	46,851	24,608
Current portion of long-term debt	30,088	14,925
Total current liabilities	1,386,907	1,033,676
LONG-TERM LIABILITIES	30,943	24,673
LONG-TERM DEBT	30,509	210,397
CONVERTIBLE PREFERRED SECURITIES OF SUBSIDIARY	--	229,854
SHAREHOLDERS' EQUITY		
Preferred stock, $1.00 par value:		
Authorized - 400,000 shares;		
Issued and outstanding - none	--	--
Common stock, $.10 par value:		
Authorized - 400,000,000 shares;		
Issued and outstanding 203,621,000 and 178,504,000 shares, respectively	10,181	4,463
Additional paid-in capital	542,377	266,144
Retained earnings	511,576	287,139
Total shareholders' equity	1,064,134	557,746
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$2,512,493	$2,056,346

CONSOLIDATED STATEMENTS OF EARNINGS

$ IN THOUSANDS, EXCEPT PER SHARE AMOUNTS

FOR THE FISCAL YEARS ENDED	FEB. 27 1999	FEB. 28 1998	MARCH 1 1997
REVENUES	$10,077,906	$8,358,212	$7,770,683
COST OF GOODS SOLD	8,250,123	7,026,074	6,711,802
GROSS PROFIT	1,827,783	1,332,138	1,058,881
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	1,463,281	1,145,280	1,005,675
OPERATING INCOME	364,502	186,858	53,206
NET INTEREST INCOME (EXPENSE)	435	(33,005)	(50,338)
EARNINGS BEFORE INCOME TAX EXPENSE	364,937	153,853	2,868
INCOME TAX EXPENSE	140,500	59,400	1,120
NET EARNINGS	$ 224,437	$ 94,453	$ 1,748
BASIC EARNINGS PER SHARE	$ 1.13	$ .54	$ .01
DILUTED EARNINGS PER SHARE	$ 1.07	$ .52	$ .01
BASIC WEIGHTED AVERAGE COMMON SHARES OUTSTANDING (000'S)	199,185	175,416	172,686
DILUTED WEIGHTED AVERAGE COMMON SHARES OUTSTANDING (000'S)	210,006	200,251	174,491

CONSOLIDATED STATEMENTS OF CASH FLOWS

$ IN THOUSANDS

FOR THE FISCAL YEARS ENDED	FEB. 27 1999	FEB. 28 1998	MARCH 1 1997
OPERATING ACTIVITIES			
Net earnings	$ 224,437	$ 94,453	$ 1,748
Depreciation, amortization and other non-cash charges	78,367	71,584	67,312
	302,804	166,037	69,060
Changes in operating assets and liabilities:			
Receivables	(36,699)	(16,121)	41,857
Merchandise inventories	14,422	71,271	69,083
Other current assets	854	4,657	8,174
Accounts payable	249,094	147,340	(152,491)
Other liabilities	109,713	43,500	(26,053)
Income taxes payable	22,243	33,759	3,579
Total cash provided by operating activities	662,431	450,443	13,209
INVESTING ACTIVITIES			
Additions to property and equipment	(165,698)	(72,063)	(87,593)
(Increase) decrease in recoverable costs from developed properties	(65,741)	45,270	72,752
(Increase) decrease in other assets	(18,128)	4,494	(5,593)
Total cash used in investing activities	(249,567)	(22,299)	(20,434)
FINANCING ACTIVITIES			
Long-term debt payments	(165,396)	(22,694)	(25,694)
Long-term debt borrowings	--	10,000	33,542
Common stock issued	20,644	14,869	2,740
Repurchase of common stock	(2,462)	--	--
Total cash (used in) provided by financing activities	(147,214)	2,175	10,588
INCREASE IN CASH AND CASH EQUIVALENTS	265,650	430,319	3,363
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	520,127	89,808	86,445
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 785,777	$ 520,127	$ 89,808

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
AND INDEPENDENT AUDITOR'S REPORT

$ IN THOUSANDS

	COMMON STOCK	ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS
BALANCES AT MARCH 2, 1996	$ 4,284	$ 236,392	$ 190,938
Stock options exercised	45	2,695	--
Tax benefit from stock options exercised	--	2,213	--
Net earnings	--	--	1,748
BALANCES AT MARCH 1, 1997	4,329	241,300	192,686
Stock options exercised	134	14,056	--
Tax benefit from stock options exercised	--	10,642	--
Conversion of preferred securities	--	146	--
Net earnings	--	--	94,453
BALANCES AT FEBRUARY 28, 1998	4,463	266,144	287,139
Stock options exercised	199	21,381	--
Tax benefit from stock options exercised	--	40,428	--
Conversion of preferred securities	509	221,896	--
May 1998 two-for-one stock split	5,016	(5,016)	--
Repurchase of common stock	(6)	(2,456)	--
Net earnings	--	--	224,437
BALANCES AT FEBRUARY 27, 1999	$ 10,181	$ 542,377	$ 511,576

OPERATING LEASE COMMITMENTS AND RELATED PARTY TRANSACTIONS

The Company conducts essentially all of its retail and distribution operations from leased locations. Transaction costs associated with the sale and leaseback of properties and any gain or loss are recognized over the terms of the lease agreements. Proceeds from the sale and leaseback of properties are included in the net change in recoverable costs from developed properties. The Company also leases various equipment under operating leases. In addition, the Company had leased 17 stores and a distribution center, along with the related fixtures and equipment under a master lease agreement through February 1998. The leases on these properties were terminated in fiscal 1998 and the properties were re-leased under long-term leases. The Company purchased the fixtures and equipment from the lessor. The leases require payment of real estate taxes, insurance and common area maintenance. Most of the leases contain renewal options and escalation clauses, and several require contingent rents based on specified percentages of sales. Certain leases also contain covenants related to maintenance of financial ratios.

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

	1999	1998	1997
MINIMUM RENTALS	$ 186,100	$ 161,500	$ 139,200
PERCENTAGE RENTALS	500	400	500
	$ 186,600	$ 161,900	$ 139,700

Future minimum lease obligations by year (not including percentage rentals) for all operating leases at February 27, 1999, are as follows:

FISCAL YEAR	
2000	$ 184,700
2001	182,900
2002	180,000
2003	171,700
2004	167,200
THEREAFTER	1,584,100

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. as of February 27, 1999, and February 28, 1998, and the related consolidated statements of earnings, changes in shareholders' equity, and cash flows for each of the three years in the period ended February 27, 1999. 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 generally accepted auditing standards. 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. at February 27, 1999, and February 28, 1998, and the consolidated results of its operations and its cash flows for each of the three years in the period ended February 27, 1999, in conformity with generally accepted accounting principles.

/s/ Ernst & Young LLP

Minneapolis, Minnesota
March 30, 1999

	Comps
Gross Profit Margin [1998]	27.3%
Gross Profit Margin [5 yr average]	24.8%
EBITD margin [1998]	2.9%
EBITD margin [5 yr average]	3.0%
Operating Profit Margin [1998]	1.2%
Operating Profit Margin [5 yr average]	2.7%
Accounts Receivable in days	9.0
Inventory days	76.0
Asset Turnover	3.2
PE	42
Current Ratio	1.6
Total Debt/Equity	0.43
Interest Coverage	6.6

END