

Edgar Filing: CIRCUIT CITY STORES INC - Form 10-Q

CIRCUIT CITY STORES INC  
Form 10-Q  
October 11, 2001

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934  
For the Quarterly Period Ended August 31, 2001

Commission File Number 1-5767

CIRCUIT CITY STORES, INC.  
(Exact Name of Registrant as Specified in its Charter)

|                          |   |
|--------------------------|---|
| VIRGINIA                 | 54-0493875                              |
| -----                    | -----                                   |
| (State of Incorporation) | (I.R.S. Employer<br>Identification No.) |

9950 MAYLAND DRIVE, RICHMOND, VIRGINIA 23233  
(Address of Principal Executive Offices and Zip Code)

(804) 527-4000  
(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

|       |   |       |
|-------|---|-------|
| Yes   | X | No    |
| ----- |   | ----- |

Indicate the number of shares outstanding of each of the Registrant's classes of common stock, as of the latest practicable date.

| Class   | Outstanding |
|---|-------------|
| -----   | -----       |
| Circuit City Stores, Inc. - Circuit City Group Common Stock, par value \$0.50 |             |
| Circuit City Stores, Inc. - CarMax Group Common Stock, par value \$0.50       |             |

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CIRCUIT CITY STORES, INC. AND SUBSIDIARIES

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CIRCUIT CITY STORES, INC. AND SUBSIDIARIES  
Consolidated Balance Sheets  
(Amounts in thousands except share data)

|   | Aug. 31, 2001<br>(Unaudited) | Feb. 28, |
|---|------------------------------|----------|
| ASSETS                                    |                              |          |
| Current assets:                           |                              |          |
| Cash and cash equivalents                 | \$ 823,654                   | \$ 446   |
| Net accounts receivable                   | 600,600                      | 585      |
| Inventory                                 | 1,560,461                    | 1,757    |
| Prepaid expenses and other current assets | 41,692                       | 57       |
|   | -----                        | -----    |
| Total current assets                      | 3,026,407                    | 2,847    |
| Property and equipment, net               | 898,222                      | 988      |
| Other assets                              | 34,251                       | 35       |
|   | -----                        | -----    |
| TOTAL ASSETS                              | \$ 3,958,880                 | \$ 3,871 |
|   | =====                        | =====    |

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## LIABILITIES AND STOCKHOLDERS' EQUITY

### Current liabilities:

|  |    |         |    |       |
|--|----|---------|----|-------|
| Current installments of long-term debt         | \$ | 102,441 | \$ | 132   |
| Accounts payable                               |    | 947,405 |    | 902   |
| Short-term debt                                |    | 1,570   |    | 1     |
| Accrued expenses and other current liabilities |    | 153,670 |    | 162   |
| Deferred income taxes                          |    | 103,017 |    | 92    |
|  |    | -----   |    | ----- |

|                           |  |           |  |       |
|---------------------------|--|-----------|--|-------|
| Total current liabilities |  | 1,308,103 |  | 1,291 |
|---------------------------|--|-----------|--|-------|

|  |  |        |  |       |
|--|--|--------|--|-------|
| Long-term debt, excluding current installments |  | 15,528 |  | 116   |
| Deferred revenue and other liabilities         |  | 85,880 |  | 92    |
| Deferred income taxes                          |  | 11,649 |  | 14    |
|  |  | -----  |  | ----- |

|                   |  |           |  |       |
|-------------------|--|-----------|--|-------|
| TOTAL LIABILITIES |  | 1,421,160 |  | 1,514 |
|                   |  | -----     |  | ----- |

### Stockholders' equity:

|   |  |           |  |       |
|---|--|-----------|--|-------|
| Circuit City Group common stock, \$0.50 par value;<br>350,000,000 shares authorized; 208,260,121 shares<br>issued and outstanding as of August 31, 2001 |  | 104,130   |  | 103   |
| CarMax Group common stock, \$0.50 par value;<br>175,000,000 shares authorized; 36,255,730 shares<br>issued and outstanding as of August 31, 2001        |  | 18,128    |  | 12    |
| Capital in excess of par value  |  | 793,590   |  | 642   |
| Retained earnings   |  | 1,621,872 |  | 1,597 |
|   |  | -----     |  | ----- |

|                            |  |           |  |       |
|----------------------------|--|-----------|--|-------|
| TOTAL STOCKHOLDERS' EQUITY |  | 2,537,720 |  | 2,356 |
|                            |  | -----     |  | ----- |

|  |    |           |    |       |
|--|----|-----------|----|-------|
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | \$ | 3,958,880 | \$ | 3,871 |
|  |    | =====     |    | ===== |

See accompanying notes to consolidated financial statements.

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## CIRCUIT CITY STORES, INC. AND SUBSIDIARIES Consolidated Statements of Earnings (Unaudited) (Amounts in thousands except per share data)

|                                       | Three Months Ended<br>August 31, |              |       |
|---------------------------------------|----------------------------------|--------------|-------|
|                                       | 2001                             | 2000         |       |
| Net sales and operating revenues      | \$ 2,887,915                     | \$ 3,179,781 | \$    |
| Cost of sales, buying and warehousing | 2,282,845                        | 2,477,990    |       |
| Appliance exit costs                  | -                                | 28,326       |       |
|                                       | -----                            | -----        | ----- |
| Gross profit                          | 605,070                          | 673,465      |       |
|                                       | -----                            | -----        | ----- |

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|  |           |           |       |
|--|-----------|-----------|-------|
| Selling, general and administrative expenses | 579,465   | 572,298   |       |
| Appliance exit costs                         | -         | 1,670     |       |
| Interest expense                             | 1,654     | 3,583     |       |
|  | -----     | -----     | ---   |
| Total expenses                               | 581,119   | 577,551   | ---   |
|  | -----     | -----     | ---   |
| Earnings before income taxes                 | 23,951    | 95,914    |       |
| Provision for income taxes                   | 9,101     | 36,447    |       |
|  | -----     | -----     | ---   |
| Net earnings                                 | \$ 14,850 | \$ 59,467 | \$ == |
|  | =====     | =====     | ===== |
| Net earnings attributed to:                  |           |           |       |
| Circuit City Group common stock              | \$ 6,822  | \$ 55,341 | \$    |
| CarMax Group common stock                    | 8,028     | 4,126     |       |
|  | -----     | -----     | ---   |
|  | \$ 14,850 | \$ 59,467 | \$    |
|  | =====     | =====     | ===== |
| Weighted average common shares:              |           |           |       |
| Circuit City Group:                          |           |           |       |
| Basic  | 205,329   | 203,770   |       |
|  | =====     | =====     | ---   |
| Diluted                                      | 206,924   | 205,494   |       |
|  | =====     | =====     | ---   |
| CarMax Group:                                |           |           |       |
| Basic  | 29,877    | 25,550    |       |
|  | =====     | =====     | ---   |
| Diluted                                      | 32,025    | 26,956    |       |
|  | =====     | =====     | ---   |
| Net earnings per share attributed to:        |           |           |       |
| Circuit City Group common stock:             |           |           |       |
| Basic  | \$ 0.03   | \$ 0.27   | \$    |
|  | =====     | =====     | ---   |
| Diluted                                      | \$ 0.03   | \$ 0.27   | \$    |
|  | =====     | =====     | ---   |
| CarMax Group common stock:                   |           |           |       |
| Basic  | \$ 0.27   | \$ 0.16   | \$    |
|  | =====     | =====     | ---   |
| Diluted                                      | \$ 0.25   | \$ 0.15   | \$    |
|  | =====     | =====     | ---   |
| Dividends paid per share:                    |           |           |       |
| Circuit City Group common stock              | \$ 0.0175 | \$ 0.0175 | \$    |
|  | =====     | =====     | ---   |
| CarMax Group common stock                    | \$ -      | \$ -      | \$    |
|  | =====     | =====     | ---   |

See accompanying notes to consolidated financial statements.

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## CIRCUIT CITY STORES, INC. AND SUBSIDIARIES Consolidated Statements of Cash Flows (Unaudited) (Amounts in thousands)

|  | Six Months<br>August<br>2001 |
|--|------------------------------|
| Operating Activities:  |                              |
| Net earnings   | \$ 31,817                    |
| Adjustments to reconcile net earnings to net cash provided by (used in) operating activities of continuing operations: |                              |
| Depreciation and amortization  | 77,682                       |
| (Gain) loss on sales of property and equipment   | (4,742)                      |
| Deferred income taxes  | 7,238                        |
| Changes in operating assets and liabilities:   |                              |
| Increase in net accounts receivable  | (14,835)                     |
| Decrease (increase) in inventory   | 197,203                      |
| Decrease (increase) in prepaid expenses and other current assets   | 15,936                       |
| (Increase) decrease in other assets  | (488)                        |
| Increase in accounts payable, accrued expenses and other current liabilities   | 46,318                       |
| Increase (decrease) in deferred revenue and other liabilities  | 4,215                        |
| Net cash provided by (used in) operating activities of continuing operations   | 360,344                      |
| Investing Activities:  |                              |
| Cash used in business acquisitions   | -                            |
| Purchases of property and equipment  | (91,468)                     |
| Proceeds from sales of property and equipment  | 110,644                      |
| Net cash provided by (used in) investing activities of continuing operations   | 19,176                       |
| Financing Activities:  |                              |
| Proceeds from issuance of (payments on) short-term debt, net   | 370                          |
| Principal payments on long-term debt   | (130,556)                    |
| Issuances of Circuit City Group common stock, net  | 13,916                       |
| Issuances of CarMax Group common stock, net  | 500                          |
| Proceeds from CarMax Group stock offering, net   | 139,685                      |
| Dividends paid on Circuit City Group common stock  | (7,260)                      |
| Net cash provided by (used in) financing activities of continuing operations   | 16,655                       |
| Cash used in discontinued operations   | (18,652)                     |
| Increase (decrease) in cash and cash equivalents   | 377,523                      |
| Cash and cash equivalents at beginning of year   | 446,131                      |
| Cash and cash equivalents at end of period   | \$ 823,654                   |

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See accompanying notes to consolidated financial statements.

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### CIRCUIT CITY STORES, INC. AND SUBSIDIARIES Notes to Consolidated Financial Statements (Unaudited)

#### 1. Basis of Presentation

The common stock of Circuit City Stores, Inc. (the "Company") consists of two common stock series that are intended to reflect the performance of the Company's two businesses. The Circuit City Group stock is intended to reflect the performance of the Circuit City store-related operations, the shares of CarMax Group stock reserved for the Circuit City Group or for issuance to holders of Circuit City Group stock and the Company's investment in Digital Video Express, which has been discontinued (see Note 8). The CarMax Group stock is intended to reflect the performance of the CarMax Group's operations. The reserved CarMax Group shares are not outstanding CarMax Group common stock. Any net earnings attributed to the reserved CarMax Group shares are not included in the CarMax Group's earnings per share calculations. As of August 31, 2001, 66,052,258 shares of CarMax Group stock were reserved for the Circuit City Group or for issuance to holders of Circuit City Group stock. The reserved CarMax Group shares represented 64.6 percent of the total outstanding and reserved shares, excluding shares reserved for CarMax employees' stock incentive plans, of CarMax Group stock at August 31, 2001, and 74.6 percent at both February 28, 2001, and August 31, 2000. The Company allocates to the Circuit City Group the portion of the net earnings of the CarMax Group attributed to the reserved CarMax Group shares. The terms of each series of common stock are discussed in detail in the Company's Form 8-A registration statement on file with the Securities and Exchange Commission.

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 the financial statements, holders of Circuit City Group stock and holders of CarMax Group 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 equity structure of the Company do not affect title to the assets or responsibility for the liabilities of the Company or any of its subsidiaries. Neither shares of CarMax Group stock nor shares of Circuit City Group stock represent a direct equity or legal interest solely in the assets and liabilities allocated to a particular group. Instead, those shares represent direct equity and legal interests in the assets and liabilities of the Company. The results of operations or financial condition of one group could affect the results of operations or financial condition of the other group. Net losses of either group and dividends or distributions on, or repurchases of, Circuit City Group stock or CarMax Group stock will reduce funds legally available for dividends on, or repurchases of, both stocks. Accordingly, the Company's consolidated financial statements included in this report should be read in conjunction with the financial statements of each group and the Company's SEC filings.

#### 2. Accounting Policies

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The consolidated financial statements of the Company conform to accounting principles generally accepted in the United States of America. The interim period financial statements are unaudited; however, in the opinion of management, all adjustments, which consist only of normal, recurring adjustments, necessary for a fair presentation of the interim consolidated financial statements have been included. The fiscal year-end balance sheet data was derived from the audited financial statements included in the Company's fiscal 2001 Annual Report on Form 10-K.

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### 3. Net Earnings per Share

Reconciliations of the numerator and denominator of the basic and diluted net earnings per share calculations are presented below.

| (Amounts in thousands<br>except per share data)               | Three Months Ended<br>August 31, |           |
|---|----------------------------------|-----------|
|   | 2001                             | 2000      |
| -----   |                                  |           |
| Circuit City Group:   |                                  |           |
| Weighted average shares.....                                  | 205,329                          | 203,770   |
| Dilutive potential shares:                                    |                                  |           |
| Options.....  | 824                              | 1,033     |
| Restricted stock.....   | 771                              | 691       |
|   | -----                            |           |
| Weighted average shares and<br>dilutive potential shares..... | 206,924                          | 205,494   |
|   | =====                            |           |
| Net earnings available to shareholders.....                   | \$ 6,822                         | \$ 55,341 |
| Basic net earnings per share .....                            | \$ 0.03                          | \$ 0.27   |
| Diluted net earnings per share .....                          | \$ 0.03                          | \$ 0.27   |
| CarMax Group:   |                                  |           |
| Weighted average shares.....                                  | 29,877                           | 25,550    |
| Dilutive potential shares:                                    |                                  |           |
| Options.....  | 2,121                            | 1,344     |
| Restricted stock.....   | 27                               | 62        |
|   | -----                            |           |
| Weighted average shares and<br>dilutive potential shares..... | 32,025                           | 26,956    |
|   | =====                            |           |
| Net earnings available to shareholders.....                   | \$ 8,028                         | \$ 4,126  |
| Basic net earnings per share.....                             | \$ 0.27                          | \$ 0.16   |
| Diluted net earnings per share.....                           | \$ 0.25                          | \$ 0.15   |

In a public offering completed during the second quarter, Circuit City Stores, Inc. sold 9,516,800 CarMax Group shares that had previously been reserved for the Circuit City Group. Because both the earnings allocation and the outstanding CarMax shares were adjusted to reflect the impact of the sale, net earnings per CarMax Group share were not diluted by the sale. With the impact of the offering, 70.7 percent of the CarMax Group's second quarter earnings and 72.5 percent of the CarMax Group's first-half earnings



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were allocated to the Circuit City Group. For the same periods last year, 74.6 percent of the CarMax Group's earnings were allocated to the Circuit City Group. At the end of the second quarter, the reserved CarMax Group shares represented 64.6 percent of the total outstanding and reserved shares, excluding shares reserved for CarMax employees' stock incentive plans, of CarMax Group stock.

Certain options were outstanding and 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. For the three-month period ended August 31, 2001, options to purchase 6,798,996 shares of Circuit City Group stock at prices ranging from \$17.25 to \$43.03 per share were outstanding and not included in the calculation. For the three-month period ended August 31, 2000, options to purchase 5,614,789 shares of Circuit City Group stock at prices ranging from \$34.84 to \$47.53 per share were outstanding and not included in the calculation.

For the three-month period ended August 31, 2001, options to purchase 7,899 shares of CarMax Group stock at \$16.31 per share were outstanding and not included in the calculation. For the three-month period

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ended August 31, 2000, options to purchase 1,458,326 shares of CarMax Group stock at prices ranging from \$3.91 to \$16.31 per share were outstanding and not included in the calculation.

#### 4. 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 Circuit City's finance operation. For transfers of receivables that qualify as sales, the Company recognizes gains or losses as a component of Circuit City's finance operation. In these securitizations, the Company retains servicing rights and subordinated interests. Provisions under the bankcard receivables master trust agreement provide recourse to the Company for any cash flow deficiencies on \$105 million of the receivables sold. The Company believes as of August 31, 2001, no liability existed under the recourse provisions. As of August 31, 2001, the private-label master trust agreement had no recourse provisions.

At August 31, 2001, the total principal amount of loans managed was \$2,584 million. Of the total loans, the principal amount of loans securitized was \$2,564 million, and the principal amount of loans held for sale was \$20 million. The aggregate amount of loans that were 31 days or more delinquent was \$187.2 million at August 31, 2001. The principal amount of losses net of recoveries amounted to \$62.3 million for the three months ended August 31, 2001, and \$131.9 million for the six-month period ended August 31, 2001.

The Company receives annual servicing compensation approximating 2 percent of the outstanding principal loan balance of the receivables and retains the rights to future cash flows arising after the investors in the securitization trusts have received the return for which they contracted. The servicing fees specified in the credit card securitization agreements

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adequately compensate the finance operation for servicing the securitized assets. Accordingly, no servicing asset or liability has been recorded.

The table below summarizes certain cash flows received from and paid to securitization trusts:

| (Amounts in thousands)   | Three Months Ended<br>August 31, 2001 | Six Months<br>August 31 |
|--|---------------------------------------|-------------------------|
| Proceeds from new securitizations.....   | \$ 204,000                            | \$ 378                  |
| Proceeds from collections reinvested<br>in previous credit card securitizations..... | \$ 457,482                            | \$ 817                  |
| Servicing fees received.....   | \$ 12,581                             | \$ 25                   |
| Other cash flows received on retained interests*.....                                | \$ 49,721                             | \$ 93                   |

\*This amount represents cash flows received from retained interests by the transferor other than servicing fees, including cash flows from interest-only strips and cash above the minimum required level in cash collateral accounts.

In determining the fair value of retained interests, the Company estimates future cash flows using management's best estimates of key assumptions such as finance charge income, default rates, payment rates, forward yield curves and discount rates. 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 may qualify for promotional financing.

Rights recorded for future finance income from serviced assets that exceed the contractually specified servicing fees are carried at fair value, amounted to \$132.1 million at August 31, 2001, and are included in net accounts receivable. Gains of \$42.2 million on sales were recorded for the three-month period ended August 31, 2001; gains of \$79.3 million on sales were recorded for the six-month period ended August 31, 2001.

The fair value of retained interests at August 31, 2001, was \$292.5 million, with a weighted-average life ranging from 0.17 years to 2.25 years. The following table shows the key economic assumptions used in measuring the fair value of retained interests at August 31, 2001, and a sensitivity analysis showing the

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hypothetical effect on the fair value of those interests when there are unfavorable variations from the assumptions used. Key economic assumptions at August 31, 2001, are not materially different from assumptions used to measure the fair value of retained interests at the time of securitization. These sensitivities are hypothetical and should be used with caution. In this table, the effect of a variation in a particular assumption on the fair value of the retained interest is calculated without changing any other assumption; in reality, changes in one factor may result in changes in another, which might magnify or counteract the sensitivities.

| (Dollar amounts in thousands) | Assumptions Used<br>(Annual) | Impact on Fair<br>Value of 10%<br>Adverse Change | Impa<br>Val<br>Adve |
|-------------------------------|------------------------------|--|---------------------|
|-------------------------------|------------------------------|--|---------------------|

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|                    |            |    |        |    |
|--------------------|------------|----|--------|----|
| Payment rate.....  | 6.9%-10.8% | \$ | 8,798  | \$ |
| Default rate.....  | 9.1%-19.4% | \$ | 25,196 | \$ |
| Discount rate..... | 9.0%-15.0% | \$ | 2,542  | \$ |

## (B) Automobile Loan Securitizations:

The Company also has asset securitization programs, operated through special purpose subsidiaries on behalf of the CarMax Group, to finance the consumer installment credit receivables generated by CarMax's automobile loan finance operation. For transfers of receivables that qualify as sales, the Company recognizes gains or losses as a component of CarMax's finance operation. In these securitizations, the Company retains servicing rights and subordinated interests.

At August 31, 2001, the total principal amount of loans managed was \$1,434 million. Of the total loans, the principal amount of loans securitized was \$1,412 million, and the principal amount of loans held for sale or investment was \$22 million. The principal amount of loans that were 31 days or more delinquent was \$18.8 million at August 31, 2001. The principal amount of losses net of recoveries amounted to \$2.7 million for the three months ended August 31, 2001, and \$4.6 million for the six-month period ended August 31, 2001.

The Company receives annual servicing fees approximating 1 percent of the outstanding principal balance of the securitized automobile loans and retains the rights to future cash flows arising after the investors in the securitization trusts have received the return for which they contracted. The servicing fees specified in the automobile loan securitization agreements adequately compensate the finance operation for servicing the accounts. Accordingly, no servicing asset or liability has been recorded.

The table below summarizes certain cash flows received from and paid to securitization trusts:

| (Amounts in thousands)   | Three Months Ended<br>August 31, 2001 | Six<br>Aug |
|--|---------------------------------------|------------|
| Proceeds from new securitizations.....   | \$ 181,000                            | \$         |
| Proceeds from collections reinvested<br>in previous automobile loan securitizations..... | \$ 126,929                            | \$         |
| Servicing fees received.....   | \$ 3,485                              | \$         |
| Other cash flows received on retained interests*.....                                    | \$ 17,186                             | \$         |

\*This amount represents cash flows received from retained interests by the transferor other than servicing fees, including cash flows from interest-only strips and cash above the minimum required level in cash collateral accounts.

In determining the fair value of retained interests, the Company estimates future cash flows using management's best estimates of key assumptions such as finance charge income, default rates, prepayment rates and discount rates. 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 may qualify for

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promotional financing.

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Rights recorded for future finance income from serviced assets that exceed the contractually specified servicing fees are carried at fair value, amounted to \$61.2 million at August 31, 2001, and are included in net accounts receivable. Gains of \$14.7 million on sales were recorded for the three-month period ended August 31, 2001; gains of \$27.8 million on sales were recorded for the six-month period ended August 31, 2001.

The fair value of retained interests at August 31, 2001, was \$91.3 million, with a weighted-average life ranging from 0.88 years to 1.63 years. The following table shows the key economic assumptions used in measuring the fair value of retained interests at August 31, 2001, and a sensitivity analysis showing the hypothetical effect on the fair value of those interests when there are unfavorable variations from the assumptions used. Key economic assumptions at August 31, 2001, are not materially different from assumptions used to measure the fair value of retained interests at the time of securitization. These sensitivities are hypothetical and should be used with caution. In this table, the effect of a variation in a particular assumption on the fair value of the retained interest is calculated without changing any other assumption; in reality, changes in one factor may result in changes in another, which might magnify or counteract the sensitivities.

| (Dollar amounts in thousands) | Assumptions Used<br>(Annual) | Impact on Fair<br>Value of 10%<br>Adverse Change | Impact<br>Value<br>Advers |
|-------------------------------|------------------------------|--|---------------------------|
| Prepayment speed.....         | 1.5%-1.6%                    | \$ 3,133   | \$                        |
| Default rate.....             | 1.0%-1.2%                    | \$ 1,759   | \$                        |
| Discount rate.....            | 12.0%                        | \$ 1,248   | \$                        |

### 5. Financial Derivatives

On behalf of the Circuit City Group, the Company enters into interest rate cap agreements to meet the requirements of the credit card receivable securitization transactions. In the second quarter of fiscal 2002, the Company did not enter into any new interest rate caps. At August 31, 2001, the total notional amount of interest rate caps outstanding was \$839 million. Purchased interest rate caps are included in net accounts receivable and had a fair value of \$5.9 million as of August 31, 2001. Written interest rate caps are included in accounts payable and had a fair value of \$5.9 million as of August 31, 2001.

On behalf of the CarMax Group, the Company, in the second quarter of fiscal 2002, entered into three 40-month amortizing interest rate swaps related to auto loan receivable securitizations. These swaps had an initial notional amount of approximately \$215 million. The total notional amount of all swaps related to the automobile loan receivable securitizations was \$675 million at August 31, 2001, and \$299 million at February 28, 2001. These swaps are used to better match funding costs and are recorded at fair value. At August 31, 2001, these swaps totaled a net liability of \$10.3 million and are included in accounts payable.

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The market and credit risks associated with interest rate caps and 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 has entered into offsetting interest rate cap positions, and therefore, does not anticipate significant market risk arising from interest rate caps. The Company does not anticipate significant market risk from swaps, because their use is to 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.

### 6. Appliance Exit Costs

On July 25, 2000, the Company announced plans to exit the major appliance category and expand its selection of key consumer electronics and home office products in all Circuit City Superstores. A product profitability analysis had indicated that the appliance category produced below-average profits. This analysis, combined with declining sales, expected increases in appliance competition and the Company's profit expectations for the consumer electronics and home office categories led to the decision to exit the

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major appliance category. To exit the appliance business, the Company closed six distribution centers and seven service centers in fiscal 2001, one service center in August 2001 and one distribution center in September 2001 and expects to close one distribution center by the end of October 2001. The majority of these closed properties are leased. While the Company has entered into contracts to sublease some of these properties, it continues the process of preparing and marketing its remaining properties to be subleased. The Company maintains control over Circuit City's in-home major appliance repair business, although repairs are subcontracted to an unrelated third party. In the second quarter of fiscal 2001, the Company recorded appliance exit costs of \$30 million. These expenses are reported separately on the fiscal 2001 statement of earnings.

Approximately 890 employees have been terminated and approximately 60 employees will be terminated as a result of the exit from the appliance business. These reductions are mainly in the service, distribution and merchandising functions. Because severance is being paid to employees on a bi-weekly schedule based on years of service, cash payments lag job eliminations. The composition of the appliance exit cost accrual and the remaining liability at August 31, 2001, are presented below. The fixed-asset write-downs include appliance build-to-order kiosks in stores as well as non-salvageable fixed assets and leasehold improvements at the locations closed as part of the exit from the appliance business.

| (Amounts in millions)              | Total<br>Exit Costs | Expenses<br>Paid or Assets<br>Written Off | Liability<br>August 31<br>2001 |
|------------------------------------|---------------------|---|--------------------------------|
| Lease termination costs.....       | \$17.8              | \$ 4.2                                    | \$13.6                         |
| Fixed asset write-downs, net.....  | 5.0                 | 5.0                                       | -                              |
| Employee termination benefits..... | 4.4                 | 3.9                                       | 0.5                            |
| Other.....                         | 2.8                 | 2.8                                       | -                              |

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|                           |        |         |        |
|---------------------------|--------|---------|--------|
| Appliance exit costs..... | \$30.0 | \$ 15.9 | \$14.1 |
| =====                     |        |         |        |

## 7. Operating Segment Information

The Company conducts business in two operating segments: Circuit City 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 Circuit City's finance operation. This segment is engaged in the business of selling brand-name consumer electronics, information technology and entertainment software. CarMax refers to the used- and new-car retail locations bearing the CarMax name and to all related operations, such as CarMax's finance operation. Financial information for these segments for the three- and six-month periods ended August 31, 2001, and 2000, is presented below.

### Three Months Ended August 31, 2001

| (Amounts in thousands)                   | Circuit City | CarMax     | To |
|--|--------------|------------|----|
| Revenues from external customers.....    | \$ 2,036,552 | \$ 851,363 | \$ |
| Interest (income) expense.....           | (432)        | 2,086      |    |
| Depreciation and amortization.....       | 33,888       | 4,612      |    |
| (Loss) earnings before income taxes..... | (20,227)     | 44,178     |    |
| Income tax (benefit) provision.....      | (7,686)      | 16,787     |    |
| Net (loss) earnings.....                 | (12,541)     | 27,391     |    |
| Total assets.....                        | \$ 3,264,090 | \$ 694,453 | \$ |

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### Three Months Ended August 31, 2000

| (Amounts in thousands)                | Circuit City | CarMax     | To |
|---------------------------------------|--------------|------------|----|
| Revenues from external customers..... | \$ 2,506,220 | \$ 673,561 | \$ |
| Interest expense.....                 | 625          | 2,958      |    |
| Depreciation and amortization.....    | 27,819       | 4,570      |    |
| Earnings before income taxes.....     | 69,671       | 26,243     |    |
| Provision for income taxes.....       | 26,475       | 9,972      |    |
| Net earnings.....                     | 43,196       | 16,271     |    |
| Total assets.....                     | \$ 3,289,201 | \$ 643,793 | \$ |

### Six Months Ended August 31, 2001

| (Amounts in thousands)                   | Circuit City | CarMax       | To |
|--|--------------|--------------|----|
| Revenues from external customers.....    | \$ 3,918,206 | \$ 1,648,183 | \$ |
| Interest expense.....                    | 9            | 4,637        |    |
| Depreciation and amortization.....       | 68,377       | 9,305        |    |
| (Loss) earnings before income taxes..... | (35,719)     | 87,037       |    |
| Income tax (benefit) provision.....      | (13,573)     | 33,074       |    |
| Net (loss) earnings.....                 | (22,146)     | 53,963       |    |
| Total assets.....                        | \$ 3,264,090 | \$ 694,453   | \$ |

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Six Months Ended August 31, 2000

| (Amounts in thousands)                | Circuit City | CarMax       | To |
|---------------------------------------|--------------|--------------|----|
| Revenues from external customers..... | \$ 4,955,330 | \$ 1,299,302 | \$ |
| Interest expense.....                 | 3,318        | 6,486        |    |
| Depreciation and amortization.....    | 57,811       | 9,146        |    |
| Earnings before income taxes.....     | 145,016      | 48,733       |    |
| Provision for income taxes.....       | 55,106       | 18,518       |    |
| Net earnings.....                     | 89,910       | 30,215       |    |
| Total assets.....                     | \$ 3,289,201 | \$ 643,793   | \$ |

Net (loss) earnings and total assets for Circuit City on the above tables exclude the reserved CarMax shares and the discontinued Divx operations, which are discussed in Note 8.

## 8. Discontinued Operations

On June 16, 1999, Digital Video Express announced that it would cease marketing the Divx home video system and discontinue operations, but that existing, registered customers would be able to view discs during a two-year phase-out period. Discontinued operations have been segregated on the consolidated statements of cash flows. However, Divx is not segregated on the consolidated balance sheets.

The loss on the disposal includes a provision for operating losses to be incurred during the phase-out period. It also includes provisions for commitments under licensing agreements with motion picture distributors, the write-down of assets to net realizable value, lease termination costs, employee severance and benefit costs and other contractual commitments. For the quarters and six-month periods ended August 31, 2001, and 2000, the discontinued Divx operations had no impact on the earnings of Circuit City Stores, Inc.

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The net liabilities of the discontinued Divx operations, reflected in the accompanying consolidated balance sheets as of August 31, 2001, and February 28, 2001, are comprised of the following:

| (Amounts in thousands)                          | Aug. 31, 2001 | Feb. 28, 2001 |
|---|---------------|---------------|
| Current assets.....                             | \$ 66         | \$ 8          |
| Property and equipment, net.....                | -             | -             |
| Other assets.....                               | 271           | 324           |
| Current liabilities.....                        | (19,326)      | (27,522)      |
| Other liabilities.....                          | (3,582)       | (14,082)      |
| Net liabilities of discontinued operations..... | \$ (22,571)   | \$ (41,272)   |

## 9. Recent Accounting Pronouncements

In July 2000, the Financial Accounting Standards Board issued Emerging

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Issues Task Force No. 00-14, "Accounting for Certain Sales Incentives," which is effective for fiscal quarters beginning after December 15, 2001. The issue provides that sales incentives, such as mail-in rebates, offered to customers should be classified as a reduction of revenue. The Company offers certain mail-in rebates that are currently recorded in cost of sales, buying and warehousing. However, the Company expects to reclassify these rebate expenses from cost of sales, buying and warehousing to net sales and operating revenues to be in compliance with EITF No. 00-14. For the quarter ended August 31, 2001, this reclassification would have increased the gross profit margin by 0.10 percent and the expense ratio by 0.09 percent. For the six-month period ended August 31, 2001, the reclassification would have increased both the gross profit margin and the expense ratio by 0.09 percent. The Company does not expect the adoption of EITF No. 00-14 to have a material impact on its financial position, results of operations or cash flows.

In June 2001, the FASB issued Statement of Financial Accounting Standards No. 141, "Business Combinations," effective for business combinations initiated after June 30, 2001, and SFAS No. 142, "Goodwill and Other Intangible Assets," effective for fiscal years beginning after December 15, 2001. Under SFAS No. 141, the pooling of interests method of accounting for business combinations is eliminated, requiring that all business combinations initiated after the effective date be accounted for using the purchase method. Also under SFAS No. 141, identified intangible assets acquired in a purchase business combination must be separately valued and recognized on the balance sheet if they meet certain requirements. Under the provisions of SFAS No. 142, goodwill and intangible assets deemed to have indefinite lives will no longer be amortized but will be subject to annual impairment tests in accordance with the pronouncements. Other intangible assets that are identified to have finite useful lives will continue to be amortized in a manner that reflects the estimated decline in the economic value of the intangible asset and will be subject to review when events or circumstances arise which indicate impairment. Application of the nonamortization provisions of SFAS No. 142 in fiscal 2003 is not expected to have a material impact on the financial position, results of operations or cash flows of the Company. During fiscal 2003, the Company will perform the first of the required impairment tests of goodwill and indefinite-lived intangible assets, as outlined within the new pronouncements. Based on preliminary estimates as well as ongoing periodic assessments of goodwill, the Company does not expect to recognize any material impairment losses from these tests.

### 10. Reclassifications

Certain previously reported amounts have been reclassified to conform with current-year presentation.

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### ITEM 2.

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

In this discussion, "we," "our" and "Circuit City Stores" refer to Circuit City Stores, Inc. and our wholly owned subsidiaries, unless the context requires otherwise. "Circuit City business" and "Circuit City" refer to the retail operations bearing the Circuit City name and to all related operations such as product service and Circuit City's finance operation. "Circuit City Group" refers to the Circuit City business and the reserved CarMax Group shares.



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"CarMax business," "CarMax" and "CarMax Group" refer to retail locations bearing the CarMax name and to all related operations such as CarMax's finance operation.

### Net Sales and Operating Revenues and General Comments

Total sales for the second quarter of fiscal 2002 were \$2.89 billion, a decrease of 9 percent from \$3.18 billion for the same period last year. For the six months ended August 31, 2001, total sales were \$5.57 billion, an 11 percent decrease from \$6.25 billion for the same period last year. We experienced solid comparable store sales increases in digital and advanced technologies, such as digital televisions, and in new and expanded categories, such as digital imaging, video game hardware and software, DVD software and personal computer software, accessories and peripherals, added in the former appliance space. These increases were offset by the absence of major appliances, continued industry-wide weakness in personal computer sales and declines in sales of analog products and older technologies, caused in part by lower average retail sales. In the second quarter of fiscal 2002, our CarMax business continued a strong sales trend begun in fiscal 2001, with sales increasing 26 percent over the same period last year. Higher-than-anticipated sales were led by used-car sales growth driven by strong store traffic, better in-store execution and increases in average retails.

Comparable store sales changes for the second quarters of fiscal years 2002 and 2001 were as follows:

|                    | 2nd Quarter |      | Six Months |      |
|--------------------|-------------|------|------------|------|
|                    | FY02        | FY01 | FY02       | FY01 |
| Circuit City Group | (21%)       | 0%   | (23%)      | 4%   |
| CarMax Group       | 27%         | 18%  | 27%        | 16%  |

For Circuit City, comparable store sales declined 21 percent in the second quarter of fiscal 2002 and 23 percent for the six-month period ended August 31, 2001. Excluding the appliance category, from which we completed our exit in the third quarter of fiscal 2001, comparable store sales declined 9 percent in the second quarter of fiscal 2002 and 11 percent for the six-month period ended August 31, 2001. CarMax's comparable store sales increased 27 percent in the second quarter after an 18 percent increase in the same prior year period. CarMax's comparable store sales increased 27 percent for the six-month period ended August 31, 2001, after a 16 percent increase for the same period last year.

We plan to open 12 Circuit City Superstores and relocate nine Circuit City Superstores in the current fiscal year. In the first quarter of fiscal 2002, we opened one Circuit City Superstore in the Las Vegas, Nev., market and relocated one store in the Los Angeles, Calif., market. In the second quarter of fiscal

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2002, we opened four Circuit City Superstores, in Boca Raton, Fla.; Dallas, Texas; St. Louis, Mo.; and Tampa, Fla., and relocated two stores in Louisville, Ky. and Tampa, Fla. Our remodels for fiscal 2002 include 24 Circuit City Superstores in which we are testing two different remodel designs. A more extensive approach is being conducted in 10 stores in the Chicago market and two stores in Virginia and a second, less costly version is being tested in 12 stores in the Washington, D.C., and Baltimore, Md., markets. The majority of the remodeling activities were completed by the end of the second quarter.

We expect CarMax's geographic growth over the next five years to primarily include the addition of superstores in new mid-sized markets that can be served effectively with one CarMax superstore and

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additional satellite stores in existing multi-store markets. Mid-sized markets are those with populations of approximately 1 million to 2.5 million people. In late fiscal 2002, we plan to open two CarMax superstores in the mid-sized markets of Sacramento, Calif., and Greensboro, N.C. In fiscal 2003, we plan to open four to six stores, and in fiscal years 2004 through 2006, we plan to open six to eight stores per year.

For Circuit City, gross dollar sales from all extended warranty programs were 5.6 percent of sales in the second quarter of fiscal 2002 and 5.2 percent of sales in the second quarter of fiscal 2001. Third-party warranty revenue was 4.4 percent of sales in this year's second quarter and 4.1 percent in the same period last year. The total extended warranty revenue that is reported in total sales was 4.3 percent of sales in the second quarter of both fiscal 2002 and 2001.

For CarMax, gross dollar sales from all extended warranty programs were 3.9 percent of sales in the second quarters of fiscal 2002 and fiscal 2001. Third-party warranty revenue was 1.7 percent of sales, and the total extended warranty revenue that is reported in total sales was 1.7 percent of sales in the second quarter of both years.

Our operations, in common with other retailers in general, are subject to seasonal influences. Historically, the Circuit City business has realized more of its net sales and net earnings in the fourth quarter, which includes the December holiday selling season, than in any other fiscal quarter. The CarMax business, however, has experienced more of its net sales in the first half of the fiscal year. The net earnings of any interim quarter are seasonally disproportionate to net sales since administrative and certain operating expenses remain relatively constant during the year. Therefore, interim results should not be relied upon as necessarily indicative of results for the entire fiscal year.

### Cost of Sales, Buying and Warehousing

Our gross profit margin was 21.0 percent of sales in the second quarter of fiscal 2002, compared with 21.2 percent in the same period last year. For the six months ended August 31, 2001, our gross profit margin was 21.0 percent compared with 21.7 percent in the same period last year.

For Circuit City, the gross profit margin increased to 24.4 percent of sales in the second quarter from 23.3 percent in the same period last year. Excluding appliance merchandise markdowns of \$7.0 million and one-time exit costs in last year's second quarter, last year's second quarter gross profit margin was 24.7 percent. The reduction in gross profit margin, when the appliance impact is excluded, in part reflects a brief supply constraint as we made a transition in DIRECTV inventory during the quarter as well as slower wireless communications

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sales early in the quarter. The DIRECTV supply issues have since been resolved and both of these high-margin service businesses were performing well as the quarter ended. For the six months ended August 31, 2001, the gross profit margin was 24.5 percent compared with 23.8 percent in the same period last year. Excluding the impact of the appliance exit in the first half of last year, the gross profit margin for the six-month period of last year was 24.5 percent.

For CarMax, the gross profit margin was 12.7 percent of sales in the second quarter of fiscal 2002 versus 13.4 percent for the same period last year. For the six months ended August 31, 2001, the gross profit margin was 12.9 percent, compared with 13.5 percent in the same period last year. We achieved our gross profit margin dollar targets per vehicle; however, higher average retails generated a decline in the gross profit margin on a percentage basis.

### Selling, General and Administrative Expenses

Our selling, general and administrative expense ratio was 20.7 percent in the second quarter of fiscal 2002, compared with 18.1 percent for the same period last year. For the six-month period ended August 31, 2001, the Company's selling, general, and administrative expense ratio was 20.0 percent compared with 18.4 percent for the same period last year.

For Circuit City, the selling, general and administrative expense ratio was 25.4 percent of sales in the second quarter of fiscal 2002, compared with 20.5 percent for the same period last year. The prior year's second

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quarter expense ratio includes \$1.7 million of one-time appliance exit costs. Excluding these costs, the second quarter expense ratio for fiscal 2001 was 20.4 percent. The increased expense ratio in fiscal 2002 is primarily a function of lower comparable store sales. In addition, remodeling costs were higher in the second quarter of fiscal 2002, as most of the costs associated with last year's full remodels in Florida were incurred in the third quarter of fiscal 2001. Although advertising expense was higher in this year's second quarter, it did not increase for the first six months of fiscal 2002, reflecting a shift in the timing of our spending. Partially offsetting these factors, the funding cost of Circuit City's finance operation declined more rapidly than yields during both the first and second quarters. For the six-month period ended August 31, 2001, the Company's selling, general, and administrative expense ratio was 25.4 percent compared with 20.8 percent for the same period last year.

CarMax's selling, general and administrative expense ratio decreased to 7.3 percent of sales in the second quarter of fiscal 2002 from 9.1 percent of sales for the same period last year. For the six-month period ended August 31, 2001, the ratio was 7.3 percent of sales compared with 9.3 percent for the same period last year. Similar to the first quarter of this year, the expense ratio improvement reflects the significant expense leverage generated by comparable store sales growth. CarMax's finance operation also contributed to the improved ratio as lower funding costs generated higher spreads.

### Net Earnings

Net earnings for the Company decreased to \$14.9 million in the second quarter of fiscal 2002 from \$59.5 million in last year's second quarter. For the six-month period ended August 31, 2001, net earnings for the Company decreased to \$31.8 million from \$120.1 million for the same period last year. These decreases

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reflect lower earnings for the Circuit City business, partly offset by earnings increases achieved by the CarMax business.

In a public offering completed during the second quarter, the Company sold 9.5 million CarMax Group shares that had previously been reserved for the Circuit City Group. Because both the earnings allocation and the outstanding CarMax shares were adjusted to reflect the impact of the sale, net earnings per CarMax Group share were not diluted by the sale. With the impact of the offering, 70.7 percent of the CarMax Group's second quarter earnings and 72.5 percent of the CarMax Group's first-half earnings were allocated to the Circuit City Group. For the same periods last year, 74.6 percent of the CarMax Group's earnings were allocated to the Circuit City Group. At the end of the second quarter, the reserved CarMax Group shares represented 64.6 percent of the total outstanding and reserved shares, excluding shares reserved for CarMax employees' stock incentive plans, of CarMax Group stock.

For the Circuit City business, the loss before income attributed to the reserved CarMax Group shares was \$12.5 million, or 6 cents per share, in the second quarter of fiscal 2002 compared with earnings of \$43.2 million, or 21 cents per share, in last year's second quarter. For the first half of the year, the Circuit City business had a loss of \$22.1 million, or 11 cents per share, in fiscal 2002 compared with earnings of \$89.9 million, or 44 cents per share, in fiscal 2001. Excluding the fiscal 2001 non-recurring costs associated with the exit from the appliance business, earnings before income attributed to the reserved CarMax Group shares were \$66.1 million, or 32 cents per share in the second quarter of last year and \$112.8 million, or 55 cents per share, in the first six months of last year.

The net earnings attributed to the reserved CarMax Group shares were \$19.4 million in the second quarter of this year compared with \$12.1 million in last year's second quarter, and \$39.1 million in the first half of this year compared with \$22.6 million in last year's first half.

Net earnings of the Circuit City Group were \$6.8 million, or 3 cents per share, in the second quarter of fiscal 2002 versus \$55.3 million, or 27 cents per share, in the second quarter of fiscal 2001. For the first half of the year, net earnings of the Circuit City Group were \$17.0 million, or 8 cents per share, in the current fiscal year compared with \$112.5 million, or 55 cents per share, last year.

For the CarMax business, net earnings were \$27.4 million in the second quarter of fiscal 2002 compared with net earnings of \$16.3 million in last year's second quarter. For the first half of the year, the CarMax business had net earnings of \$54.0 million in fiscal 2002 compared with \$30.2 million in fiscal 2001.

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Net earnings attributed to the CarMax Group common stock were \$8.0 million, or 25 cents per share, in the second quarter of fiscal 2002 compared with \$4.1 million, or 15 cents per share, in the second quarter of last year. For the first half of the year, net earnings attributed to the CarMax Group common stock were \$14.9 million, or 50 cents per share, in the current year compared with \$7.7 million, or 28 cents per share, last year.

For the quarter and the six months, net earnings attributed to the CarMax Group stock grew faster than total net earnings and net earnings per CarMax Group share because of the impact of the sale of CarMax Group stock by the Company during the quarter.

Liquidity and Capital Resources

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Net fixed assets decreased \$90.7 million primarily as a result of the CarMax sale-leaseback transaction in this year's second quarter. The inventory decrease of \$197.2 million reflects an increased focus on inventory management in our Circuit City business, as well as the decline in Circuit City comparable store sales for the first half of this fiscal year. This decrease is partially offset by an increase in the CarMax Group's inventory in an effort to hold new-car inventories higher over the summer to assure the availability of competitively priced current model-year vehicles during the fall model changeover period. Accounts payable has increased \$44.8 million from the end of fiscal 2001 as we extended vendor payment terms in our Circuit City business. As scheduled, we used existing working capital to repay a term loan totaling \$130 million in June 2001. At August 31, 2001, we maintained a \$150 million unsecured revolving credit facility and \$195 million in committed seasonal lines of credit that are renewed annually with various banks.

Circuit City's finance operation has a master trust securitization facility that allows the transfer of its private-label credit card receivables through private placement and the public market. As of August 31, 2001, the master trust program had a total program capacity of \$1.29 billion. Circuit City's finance operation also has a master trust securitization facility related to its bankcard program. As of August 31, 2001, the bankcard master trust program had a total program capacity of \$2.15 billion. These master trust vehicles permit further expansion of the securitization programs in both the public and private markets.

We also have an asset securitization program operated through a special purpose subsidiary on behalf of CarMax, through which we sell automobile loan receivables. This program had a capacity of \$800 million as of August 31, 2001. On behalf of CarMax, we also have two public asset securitization programs under which we originally securitized \$1.30 billion of auto loan receivables. As of August 31, 2001, the two public asset securitization programs had a capacity of \$736 million. We anticipate that we will be able to expand or enter into new arrangements comparable to these securitization programs to meet future needs.

During the second quarter, we completed the public offering of 9,516,800 shares, including the underwriters' over-allotment option of 666,800 shares, of CarMax Group stock. The shares sold in the offering are shares of CarMax Group stock that previously had been reserved for the Circuit City Group or for issuance to holders of Circuit City Group stock. We allocated the net proceeds of \$139.7 million from this offering to the Circuit City Group to be used for general purposes of the Circuit City business, including the remodeling of Circuit City Superstores.

In August 2001, CarMax entered into a sale-leaseback transaction with Capital Automotive Real Estate Investment Trust covering nine superstore properties valued at \$102.4 million. This transaction was the first sale-leaseback for CarMax without Circuit City guarantees. It was entered into at competitive rates and structured with an initial lease term of 15 years with two 10-year renewal options.

We believe fiscal 2002 capital expenditures will continue to be funded through a combination of internally generated cash, sale-leaseback transactions, operating leases, floor plan financing of CarMax inventory or proceeds from the public stock offering discussed above and that securitization transactions will finance any growth in receivables.

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This report on Form 10-Q contains "forward-looking statements," which are subject to risks and uncertainties. Additional discussion of factors that could cause actual results to differ materially from management's projections, forecasts, estimates and expectations is contained in our SEC filings, including our report on Form 10-Q for the quarter ended May 31, 2001.

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### ITEM 3.

#### Circuit City Stores, Inc. Quantitative and Qualitative Disclosures About Market Risk

We centrally manage the market risk associated with the private-label and bankcard revolving loan portfolios of Circuit City's finance operation and the automobile installment loan portfolio of CarMax's finance operation. Portions of these portfolios are securitized and, therefore, are not presented on the consolidated balance sheets. Interest rate exposure relating to these receivables represents a market risk exposure that we manage with matched funding and interest rate swaps.

As of August 31, 2001, the composition of the Circuit City finance operation's private-label and bankcard portfolios had not changed significantly since February 28, 2001. However, as a result of CarMax's growth and the amortization of loans funded through public securitizations, the composition of the automobile installment loan portfolio has changed significantly.

Total principal outstanding for fixed-rate automobile loans at August 31 and February 28, 2001, was as follows:

| (Amounts in millions) | August 31 | February 28 |
|-----------------------|-----------|-------------|
| -----                 | -----     | -----       |
| Fixed-rate.....       | \$1,434   | \$1,296     |

Financing for these automobile receivables is achieved through asset securitization programs that, in turn, issue both fixed- and floating-rate securities. Receivables held by Circuit City Stores for investment or sale are financed with working capital. Financings at August 31 and February 28, 2001, were as follows:

| (Amounts in millions)               | August 31 | February 28 |
|-------------------------------------|-----------|-------------|
| -----                               | -----     | -----       |
| Fixed-rate securitizations.....     | \$ 736    | \$ 984      |
| Floating-rate securitizations       |           |             |
| synthetically altered to fixed..... | 675       | 299         |
| Floating-rate securitizations.....  | 1         | 1           |
| Held by the Company:                |           |             |
| For investment*.....                | 19        | 9           |
| For sale.....                       | 3         | 3           |
|                                     | -----     | -----       |
| Total .....                         | \$ 1,434  | \$ 1,296    |
|                                     | =====     | =====       |

\* Held by a bankruptcy remote special purpose company.

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Because programs are in place to manage interest rate exposure relating to the installment loan portfolios, we expect to experience relatively little impact as interest rates fluctuate.

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## PART I. FINANCIAL INFORMATION ITEM 1. FINANCIAL STATEMENTS

### CIRCUIT CITY STORES, INC. - CIRCUIT CITY GROUP Balance Sheets (Amounts in thousands)

|  | Aug. 31, 2001<br>(Unaudited) | Feb. 28, 2001 |
|--|------------------------------|---------------|
| <b>ASSETS</b>                                  |                              |               |
| Current assets:                                |                              |               |
| Cash and cash equivalents                      | \$ 799,097                   | \$ 437,329    |
| Net accounts receivable                        | 439,976                      | 451,099       |
| Merchandise inventory                          | 1,173,558                    | 1,410,527     |
| Prepaid expenses and other current assets      | 39,734                       | 55,317        |
|  | -----                        | -----         |
| Total current assets                           | 2,452,365                    | 2,354,272     |
| Property and equipment, net                    | 801,592                      | 796,789       |
| Reserved CarMax Group shares                   | 290,241                      | 292,179       |
| Other assets                                   | 10,470                       | 9,319         |
|  | -----                        | -----         |
| TOTAL ASSETS                                   | \$ 3,554,668                 | \$ 3,452,559  |
|  | =====                        | =====         |
| <b>LIABILITIES AND GROUP EQUITY</b>            |                              |               |
| Current liabilities:                           |                              |               |
| Current installments of long-term debt         | \$ 14,659                    | \$ 24,237     |
| Accounts payable                               | 848,229                      | 820,077       |
| Short-term debt                                | 211                          | 213           |
| Accrued expenses and other current liabilities | 129,220                      | 146,818       |
| Deferred income taxes                          | 81,666                       | 74,317        |
|  | -----                        | -----         |
| Total current liabilities                      | 1,073,985                    | 1,065,662     |
| Long-term debt, excluding current installments | 14,702                       | 33,080        |
| Deferred revenue and other liabilities         | 78,909                       | 85,329        |
| Deferred income taxes                          | 8,122                        | 11,329        |
|  | -----                        | -----         |
| TOTAL LIABILITIES                              | 1,175,718                    | 1,195,400     |
| GROUP EQUITY                                   | 2,378,950                    | 2,257,159     |
|  | -----                        | -----         |
| TOTAL LIABILITIES AND GROUP EQUITY             | \$ 3,554,668                 | \$ 3,452,559  |

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See accompanying notes to group financial statements.

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## CIRCUIT CITY STORES, INC. - CIRCUIT CITY GROUP Statements of Earnings (Unaudited) (Amounts in thousands)

|   | Three Months Ended<br>August 31, |              |    |
|---|----------------------------------|--------------|----|
|   | 2001                             | 2000         |    |
| Net sales and operating revenues  | \$ 2,036,552                     | \$ 2,506,220 | \$ |
| Cost of sales, buying and warehousing   | 1,540,008                        | 1,894,978    |    |
| Appliance exit costs  | -                                | 28,326       |    |
| Gross profit  | 496,544                          | 582,916      |    |
| Selling, general and administrative expenses  | 517,203                          | 510,950      |    |
| Appliance exit costs  | -                                | 1,670        |    |
| Interest (income) expense   | (432)                            | 625          |    |
| Total expenses  | 516,771                          | 513,245      |    |
| (Loss) earnings before income taxes and<br>income attributed to the reserved<br>CarMax Group shares | (20,227)                         | 69,671       |    |
| Income tax (benefit) provision  | (7,686)                          | 26,475       |    |
| (Loss) earnings before income attributed to<br>the reserved CarMax Group shares                     | (12,541)                         | 43,196       |    |
| Net earnings attributed to the reserved<br>CarMax Group shares                                      | 19,363                           | 12,145       |    |
| Net earnings  | \$ 6,822                         | \$ 55,341    | \$ |



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See accompanying notes to group financial statements.

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## CIRCUIT CITY STORES, INC. - CIRCUIT CITY GROUP Statements of Cash Flows (Unaudited) (Amounts in thousands)

|   | Six Months<br>August<br>2001 |
|---|------------------------------|
| Operating Activities:   |                              |
| Net earnings  | \$ 16,957                    |
| Adjustments to reconcile net earnings to net cash<br>provided by (used in) operating activities of continuing operations: |                              |
| Net earnings attributed to the reserved CarMax Group shares   | (39,103)                     |
| Depreciation and amortization   | 68,377                       |
| (Gain) loss on sales of property and equipment  | (4,742)                      |
| Deferred income taxes   | 4,142                        |
| Changes in operating assets and liabilities:  |                              |
| Decrease (increase) in net accounts receivable  | 11,127                       |
| Decrease (increase) in merchandise inventory  | 236,969                      |
| Decrease (increase) in prepaid expenses and other current assets  | 15,588                       |
| (Increase) decrease in other assets   | (1,204)                      |
| Increase in accounts payable, accrued expenses<br>and other current liabilities   | 18,284                       |
| Increase (decrease) in deferred revenue and other liabilities   | 4,080                        |
| Net cash provided by (used in) operating activities<br>of continuing operations   | 330,475                      |
| Investing Activities:   |                              |
| Purchases of property and equipment   | (82,738)                     |
| Proceeds from sales of property and equipment   | 14,300                       |
| Net cash used in investing activities of continuing operations  | (68,438)                     |
| Financing Activities:   |                              |
| Decrease in allocated short-term debt, net  | (2)                          |
| Decrease in allocated long-term debt, net   | (27,956)                     |
| Issuances of group equity, net  | 13,916                       |
| Allocated proceeds from CarMax Group stock offering, net  | 139,685                      |
| Dividends paid  | (7,260)                      |
| Net cash provided by (used in) financing activities<br>of continuing operations   | 118,383                      |
| Cash used in discontinued operations  | (18,652)                     |
| Increase (decrease) in cash and cash equivalents  | 361,768                      |
| Cash and cash equivalents at beginning of year  | 437,329                      |
| Cash and cash equivalents at end of period  | \$ 799,097                   |

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See accompanying notes to group financial statements.

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### CIRCUIT CITY STORES, INC. - CIRCUIT CITY GROUP Notes to Group Financial Statements (Unaudited)

#### 1. Basis of Presentation

The common stock of Circuit City Stores, Inc. (the "Company") consists of two common stock series that are intended to reflect the performance of the Company's two businesses. The Circuit City Group stock is intended to reflect the performance of the Circuit City store-related operations, the shares of CarMax Group stock reserved for the Circuit City Group or for issuance to holders of Circuit City Group stock and the Company's investment in Digital Video Express, which has been discontinued (see Note 6). The CarMax Group stock is intended to reflect the performance of the CarMax Group's operations. The reserved CarMax Group shares represented 64.6 percent of the total outstanding and reserved shares, excluding shares reserved for CarMax employees' stock incentive plans, of CarMax Group stock at August 31, 2001, and 74.6 percent at both February 28, 2001, and August 31, 2000. The Company allocates to the Circuit City Group the portion of net earnings of the CarMax Group attributed to the reserved CarMax Group shares. The terms of each series of common stock are discussed in detail in the Company's Form 8-A registration statement on file with the Securities and Exchange Commission.

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 the financial statements, holders of Circuit City Group stock and holders of CarMax Group 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 equity structure of the Company do not affect title to the assets or responsibility for the liabilities of the Company or any of its subsidiaries. Neither shares of CarMax Group stock nor shares of Circuit City Group stock represent a direct equity or legal interest solely in the assets and liabilities allocated to a particular group. Instead, those shares represent direct equity and legal interests in the assets and liabilities of the Company. The results of operations or financial condition of one group could affect the results of operations or financial condition of the other group. Net losses of either group and dividends or distributions on, or repurchases of, Circuit City Group stock or CarMax Group stock will reduce funds legally available for dividends on, or repurchases of, both stocks. Accordingly, the Circuit City Group financial statements included in this report should be read in conjunction with the Company's consolidated financial statements, the CarMax Group financial statements and the Company's SEC filings.

#### 2. Accounting Policies

The Circuit City Group has accounted for the reserved CarMax Group shares in a manner similar to the equity method of accounting. Accounting

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principles generally accepted in the United States of America require that the CarMax Group be consolidated with the Circuit City Group. Except for the effects of not consolidating the CarMax Group with the Circuit City Group, the financial statements of the Circuit City Group conform to accounting principles generally accepted in the United States of America. The interim period financial statements are unaudited; however, in the opinion of management, all adjustments, which consist only of normal, recurring adjustments, necessary for a fair presentation of the interim group financial statements have been included. The fiscal year-end balance sheet data was derived from the audited financial statements included in the Company's fiscal 2001 Annual Report on Form 10-K.

### 3. 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 Circuit City's finance operation. For transfers of receivables that qualify as sales, the Company recognizes gains or losses as a component of Circuit City's finance operation. In these securitizations, the Company retains servicing rights and subordinated interests. Provisions under the bankcard receivables master trust agreement provide

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recourse to the Company for any cash flow deficiencies on \$105 million of the receivables sold. The Company believes as of August 31, 2001, no liability existed under the recourse provisions. As of August 31, 2001, the private-label master trust agreement had no recourse provisions.

At August 31, 2001, the total principal amount of loans managed was \$2,584 million. Of the total loans, the principal amount of loans securitized was \$2,564 million, and the principal amount of loans held for sale was \$20 million. The aggregate amount of loans that were 31 days or more delinquent was \$187.2 million at August 31, 2001. The principal amount of losses net of recoveries amounted to \$62.3 million for the three months ended August 31, 2001, and \$131.9 million for the six-month period ended August 31, 2001.

The Company receives annual servicing compensation approximating 2 percent of the outstanding principal loan balance of the receivables and retains the rights to future cash flows arising after the investors in the securitization trusts have received the return for which they contracted. The servicing fees specified in the credit card securitization agreements adequately compensate the finance operation for servicing the securitized assets. Accordingly, no servicing asset or liability has been recorded.

The table below summarizes certain cash flows received from and paid to securitization trusts:

| (Amounts in thousands)   | Three Months Ended<br>August 31, 2001 | Six Months Ended<br>August 31, 2001 |
|--|---------------------------------------|-------------------------------------|
| Proceeds from new securitizations.....   | \$ 204,000                            | \$ 378,200                          |
| Proceeds from collections reinvested<br>in previous credit card securitizations..... | \$ 457,482                            | \$ 817,000                          |
| Servicing fees received.....   | \$ 12,581                             | \$ 25,900                           |
| Other cash flows received on retained interests*.....                                | \$ 49,721                             | \$ 93,900                           |

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\*This amount represents cash flows received from retained interests by the transferor other than servicing fees, including cash flows from interest-only strips and cash above the minimum required level in cash collateral accounts.

In determining the fair value of retained interests, the Company estimates future cash flows using management's best estimates of key assumptions such as finance charge income, default rates, payment rates, forward yield curves and discount rates. 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 may qualify for promotional financing.

Rights recorded for future finance income from serviced assets that exceed the contractually specified servicing fees are carried at fair value, amounted to \$132.1 million at August 31, 2001, and are included in net accounts receivable. Gains of \$42.2 million on sales were recorded for the three-month period ended August 31, 2001; gains of \$79.3 million on sales were recorded for the six-month period ended August 31, 2001.

The fair value of retained interests at August 31, 2001, was \$292.5 million, with a weighted-average life ranging from 0.17 years to 2.25 years. The following table shows the key economic assumptions used in measuring the fair value of retained interests at August 31, 2001, and a sensitivity analysis showing the hypothetical effect on the fair value of those interests when there are unfavorable variations from the assumptions used. Key economic assumptions at August 31, 2001, are not materially different from assumptions used to measure the fair value of retained interests at the time of securitization. These sensitivities are hypothetical and should be used with caution. In this table, the effect of a variation in a particular assumption on the fair value of the retained interest is calculated without changing any other assumption; in reality, changes in one factor may result in changes in another, which might magnify or counteract the sensitivities.

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| (Dollar amounts in thousands) | Assumptions Used<br>(Annual) | Impact on Fair<br>Value of 10%<br>Adverse Change | Impact<br>Value<br>Adverse |
|-------------------------------|------------------------------|--|----------------------------|
| Payment rate.....             | 6.9%-10.8%                   | \$ 8,798   | \$ 1                       |
| Default rate.....             | 9.1%-19.4%                   | \$ 25,196  | \$ 5                       |
| Discount rate.....            | 9.0%-15.0%                   | \$ 2,542   | \$                         |

#### 4. Financial Derivatives

On behalf of the Circuit City Group, the Company enters into interest rate cap agreements to meet the requirements of the credit card receivable securitization transactions. In the second quarter of fiscal 2002, the Company did not enter into any new interest rate caps. At August 31, 2001, the total notional amount of interest rate caps outstanding was \$839 million. Purchased interest rate caps are included in net accounts

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receivable and had a fair value of \$5.9 million as of August 31, 2001. Written interest rate caps are included in accounts payable and had a fair value of \$5.9 million as of August 31, 2001.

The market and credit risks associated with interest rate caps 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 has entered into offsetting interest rate cap positions, and therefore, does not anticipate significant market risk arising from interest rate caps. Credit risk is the exposure to nonperformance of another party to an agreement. The Company mitigates credit risk by dealing with highly rated counterparties.

### 5. Appliance Exit Costs

On July 25, 2000, the Company announced plans to exit the major appliance category and expand its selection of key consumer electronics and home office products in all Circuit City Superstores. A product profitability analysis had indicated that the appliance category produced below-average profits. This analysis, combined with declining sales, expected increases in appliance competition and the Company's profit expectations for the consumer electronics and home office categories led to the decision to exit the major appliance category. To exit the appliance business, the Company closed six distribution centers and seven service centers in fiscal 2001, one service center in August 2001 and one distribution center in September 2001 and expects to close one distribution center by the end of October 2001. The majority of these closed properties are leased. While the Company has entered into contracts to sublease some of these properties, it continues the process of preparing and marketing its remaining properties to be subleased. The Company maintains control over Circuit City's in-home major appliance repair business, although repairs are subcontracted to an unrelated third party. In the second quarter of fiscal 2001, the Company recorded appliance exit costs of \$30 million. These expenses are reported separately on the fiscal 2001 statements of earnings.

Approximately 890 employees have been terminated and approximately 60 employees will be terminated as a result of the exit from the appliance business. These reductions are mainly in the service, distribution and merchandising functions. Because severance is being paid to employees on a bi-weekly schedule based on years of service, cash payments lag job eliminations. The composition of the appliance exit cost accrual and the remaining liability at August 31, 2001, are presented below. The fixed-asset write downs include appliance build-to-order kiosks in stores as well as non-salvageable fixed assets and leasehold improvements at the locations closed as part of the exit from the appliance business.

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| (Amounts in millions)              | Total<br>Exit Costs | Expenses<br>Paid or Assets<br>Written Off | Liability a<br>August 31,<br>2001 |
|------------------------------------|---------------------|---|-----------------------------------|
| Lease termination costs.....       | \$17.8              | \$ 4.2                                    | \$13.6                            |
| Fixed asset write-downs, net.....  | 5.0                 | 5.0                                       | -                                 |
| Employee termination benefits..... | 4.4                 | 3.9                                       | 0.5                               |
| Other.....                         | 2.8                 | 2.8                                       | -                                 |

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|                           |        |         |        |
|---------------------------|--------|---------|--------|
| Appliance exit costs..... | \$30.0 | \$ 15.9 | \$14.1 |
|                           | =====  |         |        |

## 6. Discontinued Operations

On June 16, 1999, Digital Video Express announced that it would cease marketing the Divx home video system and discontinue operations, but that existing, registered customers would be able to view discs during a two-year phase-out period. Discontinued operations have been segregated on the Circuit City Group statements of cash flows. However, Divx is not segregated on the Circuit City Group balance sheets.

The loss on the disposal includes a provision for operating losses to be incurred during the phase-out period. It also includes provisions for commitments under licensing agreements with motion picture distributors, the write-down of assets to net realizable value, lease termination costs, employee severance and benefit costs and other contractual commitments. For the quarters and six-month periods ended August 31, 2001, and 2000, the discontinued Divx operations had no impact on the earnings of the Circuit City Group.

The net liabilities of the discontinued Divx operations, reflected in the accompanying group balance sheets as of August 31, 2001, and February 28, 2001, are comprised of the following:

| (Amounts in thousands)                          | Aug. 31, 2001 | Feb. 28, 2001 |
|---|---------------|---------------|
| Current assets.....                             | \$ 66         | \$ 8          |
| Property and equipment, net.....                | -             | -             |
| Other assets.....                               | 271           | 324           |
| Current liabilities.....                        | (19,326)      | (27,522)      |
| Other liabilities.....                          | (3,582)       | (14,082)      |
| Net liabilities of discontinued operations..... | \$ (22,571)   | \$ (41,272)   |

## 7. Recent Accounting Pronouncements

In July 2000, the Financial Accounting Standards Board issued Emerging Issues Task Force No. 00-14, "Accounting for Certain Sales Incentives," which is effective for fiscal quarters beginning after December 15, 2001. The issue provides that sales incentives, such as mail-in rebates, offered to customers should be classified as a reduction of revenue. The Company offers certain mail-in rebates that are currently recorded in cost of sales, buying and warehousing. However, the Company expects to reclassify these rebate expenses from cost of sales, buying and warehousing to net sales and operating revenues to be in compliance with EITF No. 00-14. For the quarter ended August 31, 2001, this reclassification would have increased the gross profit margin by 0.16 percent and the expense ratio by 0.17 percent. For the six-month period ended August 31, 2001, the reclassification would have increased the gross profit margin by 0.15

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percent and the expense ratio by 0.16 percent. The Company does not expect the adoption of EITF No. 00-14 to have a material impact on the Circuit City Group's financial position, results of operations or cash flows.

In June 2001, the FASB issued Statement of Financial Accounting Standards No. 141, "Business Combinations," effective for business combinations initiated after June 30, 2001, and SFAS No. 142, "Goodwill and Other Intangible Assets," effective for fiscal years beginning after December 15, 2001. Under SFAS No. 141, the pooling of interests method of accounting for business combinations is eliminated, requiring that all business combinations initiated after the effective date be accounted for using

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the purchase method. Also under SFAS No. 141, identified intangible assets acquired in a purchase business combination must be separately valued and recognized on the balance sheet if they meet certain requirements. Under the provisions of SFAS No. 142, goodwill and intangible assets deemed to have indefinite lives will no longer be amortized but will be subject to annual impairment tests in accordance with the pronouncements. Other intangible assets that are identified to have finite useful lives will continue to be amortized in a manner that reflects the estimated decline in the economic value of the intangible asset and will be subject to review when events or circumstances arise which indicate impairment. Application of the nonamortization provisions of SFAS No. 142 in fiscal 2003 will not have a material impact on the financial position, results of operations or cash flows of the Company.

### 8. Reclassifications

Certain previously reported amounts have been reclassified to conform with current-year presentation.

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## ITEM 2.

### CIRCUIT CITY GROUP MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

In this discussion, "we," "our" and "Circuit City Stores" refer to Circuit City Stores, Inc. and our wholly owned subsidiaries, unless the context requires otherwise. "Circuit City business" and "Circuit City" refer to the retail operations bearing the Circuit City name and to all related operations such as product service and Circuit City's finance operation. "Circuit City Group" refers to the Circuit City business and the reserved CarMax Group shares. "CarMax business," "CarMax" and "CarMax Group" refer to retail locations bearing the CarMax name and to all related operations such as CarMax's finance operation.

#### Net Sales and Operating Revenues and General Comments

Total sales for the second quarter of fiscal 2002 were \$2.04 billion, a decrease of 19 percent from \$2.51 billion for the same period last year. For the six months ended August 31, 2001, total sales were \$3.92 billion, a decrease of 21 percent from \$4.96 billion in the same period last year. We experienced solid

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comparable store sales increases in digital and advanced technologies, such as digital televisions, and in new and expanded categories, such as digital imaging, video game hardware and software, DVD software and personal computer software, accessories and peripherals, added in the former appliance space. These increases were offset by the absence of major appliances, continued industry-wide weakness in personal computer sales and declines in sales of analog products and older technologies, caused in part by lower average retail sales. Comparable store sales declined 21 percent in the second quarter of fiscal 2002 and 23 percent for the six-month period ended August 31, 2001. Excluding the appliance category, from which we completed our exit in the third quarter of fiscal 2001, comparable store sales declined 9 percent in the second quarter of fiscal 2002 and 11 percent for the six-month period ended August 31, 2001.

We plan to open 12 Circuit City Superstores and relocate nine Circuit City Superstores in the current fiscal year. In the first quarter of fiscal 2002, we opened one Circuit City Superstore in the Las Vegas, Nev., market and relocated one store in the Los Angeles, Calif., market. In the second quarter of fiscal 2002, we opened four Circuit City Superstores, in Boca Raton, Fla.; Dallas, Texas; St. Louis, Mo.; and Tampa, Fla., and relocated two stores in Louisville, Ky. and Tampa, Fla. Our remodels for fiscal 2002 include 24 Circuit City Superstores in which we are testing two different remodel designs. A more extensive approach is being conducted in 10 stores in the Chicago market and two stores in Virginia and a second, less costly version is being tested in 12 stores in the Washington, D.C., and Baltimore, Md., markets. The majority of the remodeling activities were completed by the end of the second quarter.

The table below details Circuit City retail units:

| Store Mix            | Aug. 31, 2001 | Aug. 31, 2000 | Estimate<br>Feb. 28, 2002 | Feb. 28 |
|----------------------|---------------|---------------|---------------------------|---------|
| Superstores          | 598           | 574           | 604                       | 59      |
| Circuit City Express | 29            | 41            | 20                        | 3       |
| TOTAL                | 627           | 615           | 624                       | 62      |

Gross dollar sales from all extended warranty programs were 5.6 percent of sales in the second quarter of fiscal 2002 and 5.2 percent of sales in the second quarter of fiscal 2001. Third-party warranty revenue was 4.4 percent of sales in this year's second quarter and 4.1 percent in the same period last year. The total extended warranty revenue that is reported in total sales was 4.3 percent of sales in the second quarter of both fiscal 2002 and 2001.

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The percentage of merchandise sales represented by each category is listed below:

|       | 2nd Quarter |             | Six Months  |     |
|-------|-------------|-------------|-------------|-----|
|       | Fiscal 2002 | Fiscal 2001 | Fiscal 2002 | Fis |
| Video | 38%         | 32%         | 38%         |     |



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|                        |      |      |      |
|------------------------|------|------|------|
| Audio                  | 16   | 15   | 16   |
| Information Technology | 36   | 34   | 36   |
| Entertainment          | 10   | 5    | 10   |
| Appliances             | -    | 14   | -    |
| TOTAL                  | 100% | 100% | 100% |

Circuit City's operations, in common with other retailers in general, are subject to seasonal influences. Historically, Circuit City has realized more of its net sales and net earnings in the fourth quarter, which includes the December holiday selling season, than in any other fiscal quarter. The net earnings of any interim quarter are seasonally disproportionate to net sales since administrative and certain operating expenses remain relatively constant during the year. Therefore, interim results should not be relied upon as necessarily indicative of results for the entire fiscal year.

### Cost of Sales, Buying and Warehousing

For the quarter ended August 31, 2001, Circuit City's gross profit margin increased to 24.4 percent of sales from 23.3 percent in the same period last year. Excluding appliance merchandise markdowns of \$7.0 million and one-time exit costs in last year's second quarter, last year's second quarter gross profit margin was 24.7 percent. The reduction in gross profit margin, when the appliance impact is excluded, in part reflects a brief supply constraint as we made a transition in DIRECTV inventory during the quarter as well as slower wireless communications sales early in the quarter. The DIRECTV supply issues have since been resolved and both of these high-margin service businesses were performing well as the quarter ended. For the six months ended August 31, 2001, the gross profit margin was 24.5 percent compared with 23.8 percent in the same period last year. Excluding the impact of the appliance exit in the first half of last year, the gross profit margin for the six-month period of last year was 24.5 percent.

### Selling, General and Administrative Expenses

Circuit City's selling, general and administrative expense ratio was 25.4 percent of sales in the second quarter of fiscal 2002, compared with 20.5 percent for the same period last year. The prior year's second quarter expense ratio includes \$1.7 million of one-time appliance exit costs. Excluding these costs, the second quarter expense ratio for fiscal 2001 was 20.4 percent. The increased expense ratio in fiscal 2002 is primarily a function of lower comparable store sales. In addition, remodeling costs were higher in the second quarter of fiscal 2002, as most of the costs associated with last year's full remodels in Florida were incurred in the third quarter of fiscal 2001. Although advertising expense was higher in this year's second quarter, it did not increase for the first six months of fiscal 2002, reflecting a shift in the timing of our spending. Partially offsetting these factors, the funding cost of Circuit City's finance operation declined more rapidly than yields during both the first and second quarters. For the six-month period ended August 31, 2001, the Company's selling, general, and administrative expense ratio was 25.4 percent compared with 20.8 percent for the same period last year.

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(Loss) Earnings Before Income Attributed to the Reserved CarMax Group Shares

Excluding the income attributed to the reserved CarMax Group shares, Circuit City incurred a loss for the second quarter of \$12.5 million compared with earnings of \$43.2 million for the same period last year. For the six-month period ended August 31, 2001, excluding the income attributed to the reserved CarMax Group shares, Circuit City incurred a loss of \$22.1 million compared with earnings of \$89.9 million for the same period last year.

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Net Earnings Attributed to the Reserved CarMax Group Shares

During the second quarter of fiscal 2002, the net earnings attributed to the reserved CarMax Group shares rose 59 percent to \$19.3 million compared with \$12.1 million for the same period last year. For the first six months of fiscal 2002, net earnings attributed to the reserved CarMax Group shares rose 73 percent to \$39.1 million compared with \$22.6 million for the same period last year.

Net Earnings

Net earnings for the Circuit City Group for the quarter ended August 31, 2001, were \$6.8 million compared with \$55.3 million in the same period last year. For the six-month period ended August 31, 2001, net earnings for the Circuit City Group were \$17.0 million compared with \$112.5 million for the same period last year.

Liquidity and Capital Resources

Merchandise inventory decreased \$237.0 million reflecting an increased focus on inventory management as well as the decline in comparable store sales for the first half of this fiscal year. Accounts payable has increased \$28.2 million since the end of fiscal 2001 as we extended vendor payment terms. As scheduled, we used existing working capital to repay a term loan totaling \$130 million in June 2001. Payment of corporate debt will not necessarily reduce Circuit City Group allocated debt. At August 31, 2001, we maintained a \$150 million unsecured revolving credit facility and \$195 million in committed seasonal lines of credit that are renewed annually with various banks.

Circuit City's finance operation has a master trust securitization facility that allows the transfer of its private-label credit card receivables through private placement and the public market. As of August 31, 2001, the master trust program had a total program capacity of \$1.29 billion. Circuit City's finance operation also has a master trust securitization facility related to its bankcard program. As of August 31, 2001, the bankcard master trust program had a total program capacity of \$2.15 billion. These master trust vehicles permit further expansion of the securitization programs in both the public and private markets.

Circuit City relies on the external debt we allocate to the Circuit City Group

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to provide working capital needed to fund net assets not otherwise financed through sale-leasebacks or receivable securitizations. We manage all significant financial activities of the Circuit City business on a centralized basis. Circuit City's significant financial activities are dependent on our financial condition as a whole and include the investment of surplus cash, issuance and repayment of debt, securitization of receivables and sale-leasebacks of real estate.

During the second quarter, we completed the public offering of 9,516,800 shares, including the underwriters' over-allotment option of 666,800 shares, of CarMax Group stock. The shares sold in the offering are shares of CarMax Group stock that previously had been reserved for the Circuit City Group or for issuance to holders of Circuit City Group stock. We allocated the net proceeds of \$139.7 million from this offering to the Circuit City Group to be used for general purposes of the Circuit City business, including the remodeling of Circuit City Superstores.

We believe that proceeds from sales of property and equipment and receivables, future increases in the Circuit City Stores' debt allocated to the Circuit City Group, cash generated by operations and proceeds from the public stock offering discussed above will be sufficient to fund the capital expenditures and operations of the Circuit City business.

### Forward-Looking Statements

This report on Form 10-Q contains "forward-looking statements," which are subject to risks and uncertainties. Additional discussion of factors that could cause actual results to differ materially from management's projections, forecasts, estimates and expectations is contained in our SEC filings, including our report on Form 10-Q for the quarter ended May 31, 2001.

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### ITEM 3.

#### CIRCUIT CITY GROUP QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We centrally manage the market risk associated with the private-label and bankcard revolving loan portfolios of Circuit City's finance operation. Portions of these portfolios are securitized and, therefore, are not presented on the Circuit City Group's balance sheets. Interest rate exposure relating to these receivables represents a market risk exposure that we manage with matched funding; therefore, we expect to experience relatively little impact as interest rates fluctuate.

As of August 31, 2001, the composition of the Circuit City finance operation's private-label and bankcard portfolios had not changed significantly since February 28, 2001.

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### PART I. FINANCIAL INFORMATION

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## ITEM 1. FINANCIAL STATEMENTS

### CIRCUIT CITY STORES, INC. - CARMAX GROUP

#### Balance Sheets

(Amounts in thousands)

|  | Aug. 31, 2001<br>(Unaudited) | Feb. 28, 2001 |
|--|------------------------------|---------------|
| ASSETS   |                              |               |
| Current assets:                                |                              |               |
| Cash and cash equivalents                      | \$ 24,557                    | \$ 8,802      |
| Net accounts receivable                        | 160,624                      | 134,662       |
| Inventory                                      | 386,903                      | 347,137       |
| Prepaid expenses and other current assets      | 1,958                        | 2,306         |
|  | -----                        | -----         |
| Total current assets                           | 574,042                      | 492,907       |
| Property and equipment, net                    | 96,630                       | 192,158       |
| Other assets                                   | 23,781                       | 25,888        |
|  | -----                        | -----         |
| TOTAL ASSETS                                   | \$ 694,453                   | \$ 710,953    |
|  | =====                        | =====         |
| LIABILITIES AND GROUP EQUITY                   |                              |               |
| Current liabilities:                           |                              |               |
| Current installments of long-term debt         | \$ 87,782                    | \$ 108,151    |
| Accounts payable                               | 99,176                       | 82,483        |
| Short-term debt                                | 1,359                        | 987           |
| Accrued expenses and other current liabilities | 24,450                       | 16,154        |
| Deferred income taxes                          | 21,351                       | 18,162        |
|  | -----                        | -----         |
| Total current liabilities                      | 234,118                      | 225,937       |
| Long-term debt, excluding current installments | 826                          | 83,057        |
| Deferred revenue and other liabilities         | 6,971                        | 6,836         |
| Deferred income taxes                          | 3,527                        | 3,620         |
|  | -----                        | -----         |
| TOTAL LIABILITIES                              | 245,442                      | 319,450       |
| GROUP EQUITY                                   | 449,011                      | 391,503       |
|  | -----                        | -----         |
| TOTAL LIABILITIES AND GROUP EQUITY             | \$ 694,453                   | \$ 710,953    |
|  | =====                        | =====         |

See accompanying notes to group financial statements.

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### CIRCUIT CITY STORES, INC. - CARMAX GROUP

#### Statements of Earnings (Unaudited)

(Amounts in thousands)

Three Months Ended  
August 31,  
2001 2000

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|  |            |            |    |
|--|------------|------------|----|
| Net sales and operating revenues             | \$ 851,363 | \$ 673,561 | \$ |
| Cost of sales                                | 742,837    | 583,012    |    |
| Gross profit                                 | 108,526    | 90,549     |    |
| Selling, general and administrative expenses | 62,262     | 61,348     |    |
| Interest expense                             | 2,086      | 2,958      |    |
| Total expenses                               | 64,348     | 64,306     |    |
| Earnings before income taxes                 | 44,178     | 26,243     |    |
| Provision for income taxes                   | 16,787     | 9,972      |    |
| Net earnings                                 | \$ 27,391  | \$ 16,271  | \$ |
| Net earnings attributed to:                  |            |            |    |
| Circuit City Group common stock              | \$ 19,363  | \$ 12,145  | \$ |
| CarMax Group common stock                    | 8,028      | 4,126      |    |
|  | \$ 27,391  | \$ 16,271  | \$ |

See accompanying notes to group financial statements.

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## CIRCUIT CITY STORES, INC. - CARMAX GROUP Statements of Cash Flows (Unaudited) (Amounts in thousands)

|   | Six Month<br>August<br>2001 |
|---|-----------------------------|
| Operating Activities:   |                             |
| Net earnings  | \$ 53,963                   |
| Adjustments to reconcile net earnings to net cash provided by operating activities: |                             |
| Depreciation and amortization   | 9,305                       |
| Loss on sales of property and equipment   | -                           |
| Deferred income taxes   | 3,096                       |
| Changes in operating assets and liabilities:  |                             |
| (Increase) decrease in net accounts receivable                                      | (25,962)                    |
| Increase in inventory   | (39,766)                    |
| Decrease (increase) in prepaid expenses and other current assets                    | 348                         |
| Decrease in other assets  | 716                         |
| Increase in accounts payable, accrued expenses and other                            |                             |

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|   |           |
|---|-----------|
| current liabilities   | 28,034    |
| Increase (decrease) in deferred revenue and other liabilities | 135       |
|   | -----     |
| Net cash provided by operating activities                     | 29,869    |
|   | -----     |
| Investing Activities:   |           |
| Cash used in business acquisitions                            | -         |
| Proceeds from sales of property and equipment                 | 96,344    |
| Purchases of property and equipment                           | (8,730)   |
|   | -----     |
| Net cash provided by investing activities                     | 87,614    |
|   | -----     |
| Financing Activities:   |           |
| Increase (decrease) in allocated short-term debt, net         | 372       |
| Decrease in allocated long-term debt, net                     | (102,600) |
| Issuances of group equity, net                                | 500       |
|   | -----     |
| Net cash used in financing activities                         | (101,728) |
|   | -----     |
| Increase (decrease) in cash and cash equivalents              | 15,755    |
| Cash and cash equivalents at beginning of year                | 8,802     |
|   | -----     |
| Cash and cash equivalents at end of period                    | \$ 24,557 |
|   | =====     |

See accompanying notes to group financial statements.

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### CIRCUIT CITY STORES, INC. - CARMAX GROUP Notes to Group Financial Statements (Unaudited)

#### 1. Basis of Presentation

The common stock of Circuit City Stores, Inc. (the "Company") consists of two common stock series that are intended to reflect the performance of the Company's two businesses. The Circuit City Group stock is intended to reflect the performance of the Circuit City store-related operations, the shares of CarMax Group stock reserved for the Circuit City Group or for issuance to holders of Circuit City Group stock and the Company's investment in Digital Video Express, which has been discontinued. The CarMax Group stock is intended to reflect the performance of the CarMax Group's operations. The reserved CarMax Group shares represented 64.6 percent of the total outstanding and reserved shares, excluding shares reserved for CarMax employees' stock incentive plans, of CarMax Group stock at August 31, 2001, and 74.6 percent at both February 28, 2001, and August 31, 2000. The Company allocates to the Circuit City Group the portion of net earnings of the CarMax Group attributed to the reserved CarMax Group shares. The terms of each series of common stock are discussed in detail in the Company's Form 8-A registration statement on file with the Securities

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and Exchange Commission.

Notwithstanding the attribution of the Company's assets and liabilities, including contingent liabilities, and stockholders' equity between the CarMax Group and the Circuit City Group for the purposes of preparing the financial statements, holders of CarMax Group stock and holders of Circuit City Group 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 equity structure of the Company do not affect title to the assets or responsibility for the liabilities of the Company or any of its subsidiaries. Neither shares of CarMax Group stock nor shares of Circuit City Group stock represent a direct equity or legal interest solely in the assets and liabilities allocated to a particular group. Instead, those shares represent direct equity and legal interests in the assets and liabilities of the Company. The results of operations or financial condition of one group could affect the results of operations or financial condition of the other group. Net losses of either group and dividends or distributions on, or repurchases of, Circuit City Group stock or CarMax Group stock will reduce funds legally available for dividends on, or repurchases of, both stocks. Accordingly, the CarMax Group financial statements included in this report should be read in conjunction with the Company's consolidated financial statements, the Circuit City Group financial statements and the Company's SEC filings.

### 2. Accounting Policies

The financial statements of the CarMax Group conform to accounting principles generally accepted in the United States of America. The interim period financial statements are unaudited; however, in the opinion of management, all adjustments, which consist only of normal, recurring adjustments, necessary for a fair presentation of the interim group financial statements have been included. The fiscal year-end balance sheet data was derived from the audited financial statements included in the Company's fiscal 2001 Annual Report on Form 10-K.

### 3. Securitizations

The Company has asset securitization programs, operated through special purpose subsidiaries on behalf of the CarMax Group, to finance the consumer installment credit receivables generated by CarMax's automobile loan finance operation. For transfers of receivables that qualify as sales, the Company recognizes gains or losses as a component of CarMax's finance operation. In these securitizations, the Company retains servicing rights and subordinated interests.

At August 31, 2001, the total principal amount of loans managed was \$1,434 million. Of the total loans, the principal amount of loans securitized was \$1,412 million, and the principal amount of loans held for sale or

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investment was \$22 million. The principal amount of loans that were 31 days or more delinquent was \$18.8 million at August 31, 2001. The principal amount of losses net of recoveries amounted to \$2.7 million for the three months ended August 31, 2001, and \$4.6 million for the six-month period ended August 31, 2001.

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The Company receives annual servicing fees approximating 1 percent of the outstanding principal balance of the securitized automobile loans and retains the rights to future cash flows arising after the investors in the securitization trusts have received the return for which they contracted. The servicing fees specified in the automobile loan securitization agreements adequately compensate the finance operation for servicing the accounts. Accordingly, no servicing asset or liability has been recorded.

The table below summarizes certain cash flows received from and paid to securitization trusts:

| (Amounts in thousands)   | Three Months Ended<br>August 31, 2001 | Six Months Ended<br>August 31, 2001 |
|--|---------------------------------------|-------------------------------------|
| Proceeds from new securitizations.....   | \$ 181,000                            | \$ 376,000                          |
| Proceeds from collections reinvested<br>in previous automobile loan securitizations..... | \$ 126,929                            | \$ 218,394                          |
| Servicing fees received.....   | \$ 3,485                              | \$ 6,737                            |
| Other cash flows received on retained interests*....                                     | \$ 17,186                             | \$ 30,572                           |

\*This amount represents cash flows received from retained interests by the transferor other than servicing fees, including cash flows from interest-only strips and cash above the minimum required level in cash collateral accounts.

In determining the fair value of retained interests, the Company estimates future cash flows using management's best estimates of key assumptions such as finance charge income, default rates, prepayment rates and discount rates. 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 may qualify for promotional financing.

Rights recorded for future finance income from serviced assets that exceed the contractually specified servicing fees are carried at fair value, amounted to \$61.2 million at August 31, 2001, and are included in net accounts receivable. Gains of \$14.7 million on sales were recorded for the three-month period ended August 31, 2001; gains of \$27.8 million on sales were recorded for the six-month period ended August 31, 2001.

The fair value of retained interests at August 31, 2001, was \$91.3 million, with a weighted-average life ranging from 0.88 years to 1.63 years. The following table shows the key economic assumptions used in measuring the fair value of retained interests at August 31, 2001, and a sensitivity analysis showing the hypothetical effect on the fair value of those interests when there are unfavorable variations from the assumptions used. Key economic assumptions at August 31, 2001, are not materially different from assumptions used to measure the fair value of retained interests at the time of securitization. These sensitivities are hypothetical and should be used with caution. In this table, the effect of a variation in a particular assumption on the fair value of the retained interest is calculated without changing any other assumption; in reality, changes in one factor may result in changes in another, which might magnify or counteract the sensitivities.

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| (Dollar amounts in thousands) | Assumptions Used<br>(Annual) | Value of 10%<br>Adverse Change | Value of 20%<br>Adverse Change |
|-------------------------------|------------------------------|--------------------------------|--------------------------------|
| Prepayment speed.....         | 1.5%-1.6%                    | \$ 3,133                       | \$ 6,490                       |
| Default rate.....             | 1.0%-1.2%                    | \$ 1,759                       | \$ 3,517                       |
| Discount rate.....            | 12.0%                        | \$ 1,248                       | \$ 2,468                       |

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#### 4. Financial Derivatives

On behalf of the CarMax Group, the Company, in the second quarter of fiscal 2002, entered into three 40-month amortizing interest rate swaps related to auto loan receivable securitizations. These swaps had an initial notional amount of approximately \$215 million. The total notional amount of all swaps related to the automobile loan receivable securitizations was \$675 million at August 31, 2001, and \$299 million at February 28, 2001. These swaps are used to better match funding costs and are recorded at fair value. At August 31, 2001, these swaps totaled a net liability of \$10.3 million and are included in accounts payable.

The market and credit risks associated with 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, because their use is to 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.

#### 5. Recent Accounting Pronouncements

In June 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 141, "Business Combinations," effective for business combinations initiated after June 30, 2001, and SFAS No. 142, "Goodwill and Other Intangible Assets," effective for fiscal years beginning after December 15, 2001. Under SFAS No. 141, the pooling of interests method of accounting for business combinations is eliminated, requiring that all business combinations initiated after the effective date be accounted for using the purchase method. Also under SFAS No. 141, identified intangible assets acquired in a purchase business combination must be separately valued and recognized on the balance sheet if they meet certain requirements. Under the provisions of SFAS No. 142, goodwill and intangible assets deemed to have indefinite lives will no longer be amortized but will be subject to annual impairment tests in accordance with the pronouncements. Other intangible assets that are identified to have finite useful lives will continue to be amortized in a manner that reflects the estimated decline in the economic value of the intangible asset and will be subject to review when events or circumstances arise which indicate impairment. Application of the nonamortization provisions of SFAS No. 142 in fiscal 2003 is not expected to have a material impact on the financial position, results of operations or cash flows of the Company. During fiscal 2003, the Company will perform the first of the required impairment tests of goodwill and indefinite-lived intangible assets, as outlined within the new pronouncements. Based on preliminary estimates as well as ongoing periodic assessments of goodwill, the Company does not expect to recognize any material impairment losses from these tests.

## 6. Reclassifications

Certain previously reported amounts have been reclassified to conform with current-year presentation.

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## ITEM 2.

CARMAX GROUP MANAGEMENT'S DISCUSSION AND ANALYSIS  
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

In this discussion, "we," "our" and "Circuit City Stores" refer to Circuit City Stores, Inc. and our wholly owned subsidiaries, unless the context requires otherwise. "CarMax business," "CarMax" and "CarMax Group" refer to retail locations bearing the CarMax name and to all related operations such as CarMax's finance operation.

Net Sales and Operating Revenues and General Comments

Total sales rose 26 percent for the quarter ended August 31, 2001, to \$851.4 million from \$673.6 million in last year's second quarter. For the six months ended August 31, 2001, total sales were \$1.65 billion, an increase of 27 percent from \$1.30 billion in the same period last year. Our CarMax business continued a strong sales trend begun in fiscal 2001. Higher-than-anticipated sales were led by used-car sales growth driven by strong store traffic, better in-store execution and increases in average retails. Comparable store sales increased 27 percent in this year's second quarter after an 18 percent increase in the same prior year period. Comparable store sales increased 27 percent for the six-month period ended August 31, 2001, after a 16 percent increase for the same period last year.

We expect CarMax's geographic growth over the next five years to primarily include the addition of superstores in new mid-sized markets that can be served effectively with one CarMax superstore and additional satellite stores in existing multi-store markets. Mid-sized markets are those with populations of approximately 1 million to 2.5 million people. In late fiscal 2002, CarMax plans to open two superstores in the mid-sized markets of Sacramento, Calif., and Greensboro, N.C. In fiscal 2003, we plan to open four to six stores, and in fiscal years 2004 through 2006, we plan to open six to eight stores per year.

The table below details CarMax retail units:

| Stores Open                | Aug. 31, 2001 | Aug. 31, 2000 | Estimate      | Feb. 2 |
|----------------------------|---------------|---------------|---------------|--------|
|                            |               |               | Feb. 28, 2002 |        |
| "C" and "B" Stores         | 14            | 14            | 14            |        |
| "A" Stores                 | 17            | 17            | 19            |        |
| Prototype Satellite Stores | 4             | 4             | 4             |        |

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|                            |    |    |    |
|----------------------------|----|----|----|
| Stand-Alone New-Car Stores | 5  | 5  | 5  |
| TOTAL                      | 40 | 40 | 42 |

Gross dollar sales from all extended warranty programs were 3.9 percent of sales in the second quarters of fiscal 2002 and fiscal 2001. Third-party warranty revenue was 1.7 percent of sales, and the total extended warranty revenue that is reported in total sales was 1.7 percent of sales in the second quarter of both years.

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The percentages of sales dollars and sales units represented by used and new vehicles for the second quarter and six-month periods are listed below:

|                  | Three Months Ended<br>August 31, |      | Six Months Ended<br>August 31, |      |
|------------------|----------------------------------|------|--------------------------------|------|
|                  | 2001                             | 2000 | 2001                           | 2000 |
| Vehicle Dollars: |                                  |      |                                |      |
| Used Vehicles    | 81%                              | 79%  | 81%                            | 80%  |
| New Vehicles     | 19%                              | 21%  | 19%                            | 20%  |
| Vehicle Units:   |                                  |      |                                |      |
| Used Vehicles    | 87%                              | 86%  | 87%                            | 86%  |
| New Vehicles     | 13%                              | 14%  | 13%                            | 14%  |

CarMax's operations, in common with other retailers in general, are subject to seasonal influences. Historically, CarMax has experienced more of its net sales in the first half of the fiscal year. The net earnings of any interim quarter are seasonally disproportionate to net sales since administrative and certain operating expenses remain relatively constant during the year. Therefore, interim results should not be relied upon as necessarily indicative of results for the entire fiscal year.

## Cost of Sales

The gross profit margin was 12.7 percent of sales in the second quarter of fiscal 2002 versus 13.4 percent for the same period last year. For the six-month period ended August 31, 2001, the gross profit margin was 12.9 percent compared with 13.5 percent for the same period last year. We achieved our gross profit margin dollar targets per vehicle; however, higher average retails generated a decline in the gross profit margin on a percentage basis.

## Selling, General and Administrative Expenses

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The selling, general and administrative expense ratio decreased to 7.3 percent of sales in the second quarter of fiscal 2002 from 9.1 percent of sales for the same period last year. For the six months ended August 31, 2001, the ratio was 7.3 percent of sales, compared with 9.3 percent in the same period last year. Similar to the first quarter of this year, the expense ratio improvement reflects the significant expense leverage generated by the comparable store sales growth. CarMax's finance operation also contributed to the improved ratio as lower funding costs generated higher spreads.

### Net Earnings

During the second quarter, CarMax's net earnings increased 68 percent to \$27.4 million from \$16.3 million in the same period last year. The net earnings attributed to the CarMax Group stock were \$8.0 million in the second quarter of fiscal 2002, compared with \$4.1 million in the same period last year. The net earnings in the six-month period ended August 31, 2001, were \$54.0 million compared with \$30.2 million in the same period last year. In the six-month period ended August 31, 2001, the net earnings attributed to the CarMax Group stock were \$14.9 million compared with \$7.7 million in the same period last year.

### Liquidity and Capital Resources

Net fixed assets decreased \$95.5 million as a result of the sale-leaseback transaction in this year's second quarter. Inventory increased \$39.8 million in an effort to hold new-car inventories higher over the summer to assure availability of competitively priced current model-year vehicles during the fall model changeover period.

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Net accounts receivable increased by \$26.0 million, reflecting an increase in auto loans generated by higher sales volume. As scheduled, we used existing working capital to repay a term loan totaling \$130 million in June 2001. Payment of corporate debt will not necessarily reduce CarMax Group allocated debt. At August 31, 2001, we maintained a \$150 million unsecured revolving credit facility and \$195 million in committed seasonal lines of credit that are renewed annually with various banks.

We also have an asset securitization program operated through a special purpose subsidiary on behalf of CarMax, through which we sell automobile loan receivables. This program had a capacity of \$800 million as of August 31, 2001. On behalf of CarMax, we also have two public asset securitization programs under which we originally securitized \$1.30 billion of auto loan receivables. As of August 31, 2001, the two public asset securitization programs had a capacity of \$736 million. We anticipate that we will be able to expand or enter into new arrangements comparable to these securitization programs to meet future needs.

CarMax relies on the external debt we allocate to the CarMax Group to provide working capital needed to fund net assets not otherwise financed through sale-leasebacks or receivable securitizations. We manage most of the significant financial activities of the CarMax business on a centralized basis. CarMax's significant financial activities are dependent on our financial condition as a whole and include the investment of surplus cash, issuance and repayment of debt, securitization of receivables and sale-leasebacks of real estate.

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During the second quarter, we completed the public offering of 9,516,800 shares, including the underwriters' over-allotment option of 666,800 shares, of CarMax Group stock. The shares sold in the offering were shares of CarMax Group stock that previously had been reserved for the Circuit City Group or for issuance to holders of Circuit City Group stock. We allocated the net proceeds of \$139.7 million from this offering to the Circuit City Group to be used for general purposes of the Circuit City business, including the remodeling of Circuit City Superstores.

In August 2001, CarMax entered into a sale-leaseback transaction with Capital Automotive Real Estate Investment Trust covering nine superstore properties valued at \$102.4 million. This transaction was the first sale-leaseback for CarMax without Circuit City guarantees. It was entered into at competitive rates and structured with an initial lease term of 15 years with two 10-year renewal options.

We believe that proceeds from sales of property and equipment and receivables, future increases in Circuit City Stores' debt allocated to the CarMax Group, inter-group loans, floor plan financing and cash generated by operations will be sufficient to fund the capital expenditures and operations of the CarMax business.

### Forward-Looking Statements

This report on Form 10-Q contains "forward-looking statements," which are subject to risks and uncertainties. Additional discussion of factors that could cause actual results to differ materially from management's projections, forecasts, estimates and expectations is contained in our SEC filings, including our report on Form 10-Q for the quarter ended May 31, 2001.

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### ITEM 3.

#### CARMAX GROUP QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We centrally manage the market risk associated with the automobile installment loan portfolio of CarMax's finance operation. A portion of this portfolio is securitized and, therefore, is not presented on the CarMax Group's balance sheets. Interest rate exposure relating to these receivables represents a market risk exposure that we manage with matched funding and interest rate swaps.

Total principal outstanding for fixed-rate automobile loans at August 31 and February 28, 2001, was as follows:

| (Amounts in millions) | August 31 | February 28 |
|-----------------------|-----------|-------------|
| Fixed-rate.....       | \$1,434   | \$1,296     |

Financing for these receivables is achieved through asset securitization programs that, in turn, issue both fixed- and floating-rate securities. Receivables held by Circuit City Stores for investment or sale are financed with working capital. Financings at August 31 and February 28, 2001, were as follows:

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| (Amounts in millions)               | August 31 | February 28 |
|-------------------------------------|-----------|-------------|
| Fixed-rate securitizations.....     | \$ 736    | \$ 984      |
| Floating-rate securitizations       |           |             |
| synthetically altered to fixed..... | 675       | 299         |
| Floating-rate securitizations.....  | 1         | 1           |
| Held by the Company:                |           |             |
| For investment*.....                | 19        | 9           |
| For sale.....                       | 3         | 3           |
| Total.....                          | \$1,434   | \$1,296     |
|                                     | =====     | =====       |

\* Held by a bankruptcy remote special purpose company.

Because programs are in place to manage interest rate exposure relating to the installment loan portfolio, we expect to experience relatively little impact as interest rates fluctuate.

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## PART II. OTHER INFORMATION

### Item 6. Exhibits and Reports on Form 8-K

#### (a) Exhibits

- (4) Second Amended and Restated Rights Agreement dated as of July 10, 2001 between Circuit City Stores, Inc. and Wells Fargo Bank Minnesota, N.A. (incorporated by reference to Exhibit 1 to Circuit City Stores, Inc. Form 8A/A filed July 20, 2001 (File No. 001-05767)).

#### (b) Reports on Form 8-K

None.

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## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CIRCUIT CITY STORES, INC.

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By: s/ W. Alan McCollough

-----  
W. Alan McCollough  
President and  
Chief Executive Officer

By: s/ Michael T. Chalifoux

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Michael T. Chalifoux  
Executive Vice President,  
Chief Financial Officer and  
Corporate Secretary

By: s/ Philip J. Dunn

-----  
Philip J. Dunn  
Senior Vice President, Treasurer,  
Corporate Controller and  
Chief Accounting Officer

October 11, 2001

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