CIRCUIT CITY STORES INC
Form 10-K
April 30, 2007
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended February 28, 2007

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from ______ to ______

Commission File Number: 1-5767

CIRCUIT CITY STORES, INC.

(Exact name of registrant as specified in its charter)

VIRGINIA	**54-0493875**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**
9950 Mayland Drive	**23233**

Richmond, Virginia
(Address of principal executive offices) **(Zip Code)**
Registrant s telephone number, including area code: (804) 486-4000

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, Par Value $0.50 per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

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 by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

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

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

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

The aggregate market value of the registrant s common shares held by non-affiliates as of August 31, 2006, which was the last business day of the registrant s most recently completed second fiscal quarter, was $4,075,922,680 based upon the closing price of these shares as reported by the New York Stock Exchange on that date.

On March 31, 2007, the company had outstanding 170,740,087 shares of common stock.

Table of Contents

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the company s Definitive Proxy Statement dated April 27, 2007, furnished to shareholders of the company in connection with the 2007 Annual Meeting of Shareholders are incorporated by reference in Part III of this Annual Report on Form 10-K.

TABLE OF CONTENTS

Table of Contents

PART I

Item 1. Business.

Circuit City Stores, Inc. is a leading specialty retailer of consumer electronics, home office products, entertainment software, and related services. Circuit City was incorporated under the laws of the Commonwealth of Virginia in 1949. Its corporate headquarters are located at 9950 Mayland Drive, Richmond, Virginia. The company has two reportable segments: its domestic segment and its international segment. For fiscal 2007, net sales were $11.86 billion for the domestic segment and $570.2 million for the international segment. Prior to the second quarter of fiscal 2005, the company had another reportable segment, its finance operation that was sold in May 2004.

The domestic segment is engaged in the business of selling brand-name consumer electronics, personal computers, entertainment software, and related services in Circuit City stores in the United States and via the Web at www.circuitcity.com and www.firedog.com. At February 28, 2007, the company s domestic segment operated 642 Superstores and 12 other stores in 158 U.S. media markets.

The international segment, which is comprised of the operations of InterTAN, Inc., is engaged in the business of selling private-label and brand-name consumer electronics in Canada. At February 28, 2007, the international segment conducted business through 806 retail stores and dealer outlets, which consisted of 509 company-owned stores, 296 dealer outlets and 1 Battery Plus® store. The international segment re-branded most of its company-owned stores and dealer outlets to The Source By Circuit City℠ during fiscal 2006. The international segment operates a Web site at www.thesource.ca. In February 2007, the board of directors authorized management to explore strategic alternatives for InterTAN, Inc., which could include the sale of the operation.

Additional discussion of Circuit City s operating segments is included in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations and Note 17, Segment Information, of the Notes to Consolidated Financial Statements, included in Item 8, Financial Statements and Supplementary Data, of this Annual Report on Form 10-K.

The company is in the midst of a retail and merchandising transformation, with the goal of continuing to improve its core business through growing sales, improving gross profit margins, reducing expenses and improving working capital management. During this transformation period, the company will make significant investments in information systems, multi-channel capabilities, innovation activities and real estate. The company has implemented a disciplined innovation process to enable future growth by appealing to new customers, providing new product and service offerings and searching for new business opportunities.

In February 2007, the company changed its executive management structure to improve execution and accountability, to better align all retail channels and to increase the coordination between merchandising and marketing. The executive vice president of merchandising, services and marketing oversees the merchandising, supply chain, services and marketing organizations. These organizations are tasked with the creation and communication of the company s value propositions to the customer. All retail channels, including all domestic and international segment retail stores and direct channels, report to the executive vice president, multi-channel sales.

Multi-channel Operations

Circuit City has a highly integrated multi-channel business model, which allows customers to shop in its stores, on the Web and via the telephone. Store operations are managed by an executive vice president, multi-channel sales, who oversees sales conversion and the customer experience.

During fiscal 2007, the domestic segment retail operations were divided into 10 regions, which were under the supervision of regional vice presidents. The 10 regions were comprised of 67 districts, which were managed by district managers who regularly visit stores to monitor store operations and meet with store directors. In early fiscal 2008, the number of regions was reduced to eight. Domestic segment Superstores are typically staffed with an average of 56 full-time and part-time Associates including sales support personnel, such as customer service Associates, product specialists and stockpersons; in-store technicians and installers; sales managers; an operations manager; and a store director.

Table of Contents

The company s direct-to-consumer business has grown rapidly since the launch of its Web site in 1999. Through www.circuitcity.com and the company s telephone call center, customers have access to a wide selection of consumer electronics, technology and entertainment products, and related services as well as around-the-clock customer service. The company s Web site at www.circuitcity.com offers more than 150,000 customer ratings and reviews of products, as well as in-depth product and technology information. Customers may view real-time in-store inventory of products selected on www.circuitcity.com, purchase the products online, and pick up the products in a nearby store. As an enhancement of its multi-channel capabilities, Circuit City offers a 24/24 Pickup Guarantee[SM] for qualifying purchases made through its Web site or telephone call centers. Under this policy, qualifying purchases will be ready for customers to pick up at their designated store within 24 minutes of purchase confirmation, or the customer will receive a $24 Circuit City gift card. During fiscal 2007, approximately 54 percent of online sales were picked up in a store.

At February 28, 2007, the domestic segment had 43,011 hourly and salaried employees. None of these employees is subject to a collective bargaining agreement. The company employs additional personnel during peak selling seasons. The company has an hourly pay structure for the domestic segment s non-management sales force. The company currently has an initiative underway to streamline store operating procedures in order to allocate store labor resources more effectively.

International segment retail stores are divided into four regions, which are managed by regional vice presidents. The 4 regions are further divided into 21 districts, which are under the supervision of district managers who regularly visit stores to monitor store operations. Dealer outlets are divided into seven areas across Canada, each of which is under the supervision of an area sales manager.

International segment stores operating under the trade name The Source By Circuit City[SM] typically have a small store format and are strategically located in malls and shopping centers. Each store provides readily available products and services to meet a wide range of consumer electronic needs. Dealer outlets are independent retail businesses that operate under their own trade names but are permitted, under dealer agreements, to purchase any of the products sold by The Source By Circuit City[SM]. The dealer agreements contain a sub-license permitting the dealers to designate their consumer electronics department or business as a The Source By Circuit City[SM] dealer.

International segment retail stores are typically staffed by 5 to 20 Associates, including full-time and part-time commissioned sales Associates and a store manager. At February 28, 2007, the international segment had 3,071 hourly and salaried Associates. Approximately 100 of these Associates, who are engaged in warehousing and distribution operations, are represented by a union. The terms of a three-year collective bargaining agreement ending in April 2009 were ratified with these employees. The company considers its relationship with the union-represented employees to be good.

Domestic segment and international segment Associates receive frequent training and development through interactive e-learning courses, workbooks and management-driven in-store mentoring. Training focuses on selling skills, product knowledge with an emphasis on new technology, customer service and store operations. Associates use Circuit City s Web site as an additional training resource for product knowledge. Management training programs are designed to prepare the company s leaders and include Web-based training, in-store activities and classroom instruction.

Merchandising

The company offers a broad selection of products and services through its stores, on the Web and via the telephone. The domestic segment s major sales categories are

- **video**, which includes televisions, imaging products, DVD hardware, camcorders, digital cameras, furniture, and related accessories;
- **information technology**, which includes personal computer hardware, telecommunications products and related accessories;

Table of Contents

- **audio**, which includes home audio products, mobile audio products, portable audio products, and related accessories;

- **entertainment**, which includes movie software, music software, game software, game hardware and personal computer software; and

- **warranty, services and other**, which includes extended warranty net sales; revenues from computer-related services, mobile installations, home theater installations and product repairs; net financing; and revenues received from third parties for services subscriptions.

To ensure consistency, each domestic segment store follows operating procedures and merchandising programs, including procedures for inventory maintenance and merchandise displays. The company currently has an initiative underway to streamline these store operating procedures in order to allocate store labor resources more effectively. Merchandise pricing may vary by market to reflect local competitive conditions.

The international segment s merchandising strategy focuses on a merchandise offering designed to increase both sales and gross profit margin. The segment intends to make fundamental changes including the following:

- optimizing assortments, including expanding assortments in strategic growth categories, narrowing assortments in other categories and increasing the sales penetration of higher margin private-label products;

- managing lifecycle transitions to new assortments to minimize markdown risk and present more current assortments to the customer;

- implementing a formal pricing strategy to leverage the company s multi-market pricing capabilities and improve margins; and

- reducing non-working inventory.

Marketing

In fiscal 2007, Circuit City began brand management initiatives designed to build a deeper customer relationship and support the company s multi-channel strategy. These initiatives include developing partnerships and alliances with third parties to build brand value; instituting more disciplined measures of return on marketing expenses to promote accountability; and promoting better cross-functional coordination within the company to create a unified and seamless customer experience. The company intends to build upon these early steps with a multi-year plan to differentiate the Circuit City brand from its competitors.

Circuit City utilizes multiple marketing vehicles to build brand awareness and promote specific products and offers. The domestic segment uses newspaper advertisements, television, direct mailings and online marketing. The company also offers a rewards credit card in partnership with Chase Card Services. Cardholders can choose rewards points or promotional financing for qualifying purchases at Circuit City. The points can be redeemed for future purchases, enabling Circuit City to reward its loyal customers while encouraging repeat traffic to its stores. During fiscal 2007, the company tested a new information system that will make it easier to publish different newspaper advertisements in different domestic segment geographic markets. The company expects to expand the use of this system in fiscal 2008.

During fiscal 2007, the domestic segment launched the firedog℠ brand to provide home theater installation and PC services in-store, at home and remotely. The brand name captures the attributes that the company wants its technicians and installers to embody: helpful, knowledgeable, friendly and reliable. The decision to build an integrated brand for both PC services and home theater installation was based on customer research and was more cost-efficient than building multiple brands.

During fiscal 2006, the international segment completed the brand transition to The Source By Circuit City℠. The company supported the brand launch with a major advertising campaign featuring television and radio commercials as well as print and outdoor advertising. The international segment is among the largest retail advertisers in Canada and advertises through multiple channels, including newspaper, television, direct mailings and radio.

Table of Contents

Supply Chain

During fiscal 2007, the company continued to make improvements to its supply chain organization and processes. Results of these improvements include improved in-stock positions, reduced net-owned inventory, decreased inactive inventory and an enhanced product offering. The company also built a vertically-integrated supply chain organization encompassing sourcing; vendor relations; logistics; distribution and warehousing; inventory management; inventory lifecycle pricing management; space planning; and supply process re-engineering. Due to this structural alignment, the company expects, over time, to be able to identify and react rapidly to changes in consumer demand as well as reduce the time from buying decision through replenishment and display of the product at the point of sale. The company is in the process of upgrading its merchandising, marketing and supply chain information systems, which will enable additional improvements and efficiencies in processes.

Circuit City relies on a best sourcing strategy to find products with the best value for the cost. Depending on the type of product, the company procures merchandise from a variety of sources and methods, including new and existing vendors, reverse auctions, and direct relationships with manufacturers. Through Circuit City Global Sourcing, Ltd., a wholly owned subsidiary, the company has developed internal sourcing capabilities, including offices in China, Hong Kong and Taiwan.

As a retailer primarily of branded consumer electronics that relies upon its ability to offer consumers a comprehensive and attractive assortment of merchandise and services, Circuit City depends upon strong and stable supplier relationships. During fiscal 2007, the domestic segment s five largest suppliers accounted for approximately 42 percent of merchandise purchased. The major suppliers were Sony, Hewlett-Packard, Samsung, Toshiba and Apple. The international segment s five largest suppliers accounted for approximately 43 percent of its merchandise purchased and were Rogers Wireless, Motorola, Acer, Apple and Panasonic.

The loss or disruption in supply from any one of these major suppliers could have a material adverse effect on the company s revenue and earnings. Circuit City has no indication that any of its major suppliers will discontinue selling merchandise to the company. The company has not experienced significant difficulty in maintaining satisfactory sources of supply and generally expects that adequate sources of supply will continue to exist for the types of merchandise sold in its stores.

Circuit City offers an increasing amount of private-label merchandise to complement its branded strategy. These unique brands supplement one of the best selections of brand-name products in the consumer electronics industry and provide an even broader selection to customers.

As of February 28, 2007, the domestic segment operated

- six automated regional electronics distribution centers;
- one smaller automated distribution center that primarily handles large non-conveyable products, such as big screen televisions;
- one automated centralized entertainment software distribution center that serves all stores; and
- one import consolidation and distribution center.

Most products are shipped from manufacturers directly to the distribution centers. Circuit City believes that the use of distribution centers enables it to efficiently distribute a broad selection of merchandise to its stores, reduce inventory levels at individual stores, benefit from volume purchasing and maintain inventory control. Some products are received directly from the manufacturer by the stores in order to reduce costs and time-to-shelf.

The international segment s stores are replenished primarily through one automated distribution center in Barrie, Ontario, Canada.

Table of Contents

Information Technology

The company is undertaking a series of critical initiatives designed to transform its information technology (IT) systems and organization. Through this multi-year process, the IT organization will

- utilize IT solutions available in the marketplace with minimal customization, resulting in a more flexible infrastructure to reduce costs;
- develop strong partnerships with IT vendors, providing a deeper pool of talent, more flexible resources and access to expertise in retail systems; and
- reduce lifetime costs and mitigate risks through simplification.

Late in fiscal 2007, the company consolidated the IT organizations that supported Circuit City s domestic segment Superstores, direct channel and the international segment. The change eliminates duplication of processes and allows the unified IT organization to build solutions that serve the company s multi-channel needs. Early in fiscal 2008, the company announced that it has entered into an agreement with IBM to outsource its IT infrastructure operations. Areas that IBM will manage for Circuit City include data center operations, store support services, e-commerce hosting operations, service desk operations, network management, network services, desktop support, enterprise systems management and IT security administration. By leveraging IBM s global resources and support structure and implementing efficient and consistent processes, tools and architectures, Circuit City estimates cost savings of more than 16 percent over the term of the contract.

The domestic segment s in-store point-of-sale (POS) systems maintain an online record of all transactions and allow management to track performance by region, store and store Associate on a near real-time basis. The information gathered by the systems supports automatic replenishment of in-store inventory from the regional distribution centers and is incorporated into product buying decisions. The in-store POS systems are seamlessly integrated with the company s e-commerce Web site. This integration provides the capability for in-store pickup of merchandise ordered from the Internet and allows for in-store ordering of merchandise for shipment directly to the customer s home. As part of an effort to eliminate complex, custom-developed information systems, the domestic segment began deployment of new POS systems to a limited number of locations during fiscal 2007. The rollout is expected to be complete during fiscal 2008. The new POS systems deliver more flexible, scalable systems to support the company s new store growth and new initiatives; allow for easier and faster training; provide enhanced data security; and enable additional capabilities for services and in-store pickup of merchandise.

For the international segment, each of the retail stores has one or more computers that serve as POS terminals and are linked to the operational headquarters. This information network provides detailed sales and margin information on a daily basis, updates the customer database and acts as a monitor of individual store performance. The POS systems also are linked directly to a system used to automatically replenish a store s stock as inventory is sold. The retail stores have in-store kiosks that allow customers to look up and order product online.

The company has implemented new data warehousing capabilities that will improve internal processes, streamline applications and allow more timely analysis of data for the domestic segment. In fiscal 2007, the domestic segment began implementing an extensive suite of systems, provided by Oracle Retail (formerly Retek), to transform its merchandising, supply chain, planning and marketing processes. The Oracle Retail implementation, known internally as the merchandising systems transformation (MST), is expected to enhance speed, flexibility, visibility and optimization across all channels and better integrate financial, assortment and space planning with forecasting and replenishment. The rollout will be a series of discrete systems releases, and each can deliver benefits upon implementation. The new systems are designed to allow the company to collaborate with its vendors and optimize pricing and space allocation in its stores. As of February 28, 2007, two modules had been implemented. The company expects the implementation of MST to be completed in fiscal 2009. The company expects the improvements to drive comparable store sales gains, through improved in-stock inventory levels, and margins, through price and promotion optimization as well as better product transition management.

Domestic Segment Superstore Revitalization

During fiscal 2001, Circuit City introduced a new Superstore format that features a brighter, more contemporary look and an open, easily navigable floor plan conducive to browsing. The format allows the company to put all products, except those that are too large for customers to carry themselves, on the sales floor. The company has improved product adjacencies so that customers can conveniently shop for products and accessories related to their core product purchase. Shopping carts, baskets and centralized cash register checkouts add to the convenience of the increased number of take-with products. The company continues to refine its store prototypes. The company s new store prototypes include both 30,000 square foot and 20,000 square foot formats. The size of the trade area is the primary driver in determining which of the two prototypes is most appropriate. During fiscal 2008, the company expects more than half of the openings to be in the 20,000 square foot format.

During fiscal 2007, the company opened 23 incremental Superstores and relocated 12 Superstores. The following table summarizes the progress of the domestic segment Superstore revitalization program over the last seven fiscal years.

Fiscal	Superstore Openings	Superstore Relocations	Full Remodels	Superstore Closures	Superstores at End of Fiscal Year
2007	23	12(a)	2(b)	8(c)	642
2006	18	10		4(a)	626
2005	31	28(d)	1	19(e)	612
2004	8	18	4	20(d,g)	599
2003	8(e)	11	3	1	611
2002	11	8	12	1	604
2001	24(f)	1	26(g)	1	594
Total	123	88	48	54	

(a) In February 2006, the company closed one store in advance of opening a replacement store in the first quarter of fiscal 2007. The replacement store is included in fiscal 2007 store relocations.

(b) One fiscal 2007 remodel consisted of rebuilding a hurricane-damaged store on the same site.

(c) In February 2007, the company closed one store in advance of opening a replacement store in the first quarter of fiscal 2008. The replacement store will be included in fiscal 2008 store relocations.

(d) On February 29, 2004, the company closed one store in advance of opening a replacement store in the first quarter of fiscal 2005. The replacement store is included in fiscal 2005 store relocations.

(e) One of the stores opened in fiscal 2003 was closed in February 2005.

(f) Two of the 24 new store openings did not have the new format.

(g) Two of the locations that were fully remodeled in fiscal 2001 were closed in February 2004.

From the beginning of fiscal 2001 through fiscal 2007, a total of 254 Superstores, or 40 percent of the company s 642 domestic segment Superstores, net of closures, have been constructed, relocated or fully remodeled under one of the new formats. During fiscal 2008, the company expects to open 60 to 65 domestic segment Superstores, of which it expects 17 to 19 will be relocations. The company expects that at February 28, 2008, approximately 46 percent of the store base will have been relocated, built in new trade areas or fully remodeled, net of closures, since the beginning of fiscal 2001.

Competition

The consumer electronics retail industry is highly competitive. Competitors include

other consumer electronics retailers,

discount retailers,

warehouse clubs,

home office retailers,

Internet-based retailers and

direct-to-consumer alternatives.

Table of Contents

Discount and warehouse club retailers continue to increase consumer electronics offerings, particularly on entry-level and less complex products. In addition, many of the company s vendors and suppliers have opened retail store locations and increased their direct sales to consumers. The company s competitors may offer products and services at lower prices; promote products and services more aggressively; offer more attractive financing; and receive more favorable product allocations than the company does. Any of these actions could adversely affect the company s sales and profit margin.

In response, Circuit City continues to build a differentiated offering based primarily on the company s growth pillars of home entertainment, services and multi-channel integration. Circuit City s domestic segment differentiates itself from competitors by offering a high level of customer service; competitive prices; complete product and service assortments; and the option of multi-channel shopping. The international segment differentiates itself from other consumer electronics retailers in Canada through its range of products and its service orientation.

Acquisition of InterTAN, Inc.

In May 2004, Circuit City completed its acquisition of InterTAN, Inc. for cash consideration of $259.3 million, which includes transaction costs and is net of cash acquired of $30.6 million. In addition to giving Circuit City a greater product-sourcing capability and the ability to accelerate the offering of private-label merchandise to its customers, the acquisition of InterTAN gave Circuit City its first presence in the Canadian market. For information regarding the company s risks associated with the international segment, see Forward-Looking Statements included in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations, and Translation of Financial Results included in Item 7A, Quantitative and Qualitative Disclosures about Market Risk, of this Annual Report on Form 10-K.

Intellectual Property

The company s principal trademarks and service marks, which are Circuit City, firedog, The Source By Circuit City, Circuit City Advantage a 24/24 Pickup Guarantee either have been registered or have trademark applications pending with the United States Patent and Trademark Office and with the trademark registries of various foreign jurisdictions. The company s rights in these trademarks and service marks continue for as long as they are used. The company believes that the Circuit City name and the circle logo design have significant value and are important to its business. The company also owns various trademarks used with private-label consumer electronics designed and manufactured by third parties for Circuit City. The company has also filed a patent application for a system and method of guided sales using a tablet personal computer.

The company has trademark applications pending in both the United States and Canada for The Source By Circuit City. The international segment also operates one store under the license for Battery Plus®. The company s InterTAN subsidiary formerly licensed marks from RadioShack Corporation to operate retail consumer electronics outlets under the RadioShack® name in Canada. All stores formerly operated under license from RadioShack Corporation were re-branded during fiscal 2006.

Seasonality

Like many retailers, Circuit City s revenues are typically greatest during the fourth fiscal quarter because it includes the majority of the holiday selling season. A corresponding pre-season inventory build during the third fiscal quarter is typically associated with this higher sales period.

Working Capital

The company funds capital expenditures and working capital needs through available cash, borrowing capacity under its $500 million credit facility and landlord reimbursements. Additional discussion of Circuit City s Liquidity and Capital Resources is included in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations, of this Annual Report on Form 10-K.

Sale of Private-Label Finance Operation

In May 2004, the company completed the sale of its private-label finance operation, comprised of its private-label and co-branded Visa credit card programs, to Chase Card Services. Results from the private-label finance operation are included in finance income on the consolidated statement of operations for fiscal 2005. The company entered into a Consumer Credit Card Program Agreement under which Chase Card Services is offering private-label and co-branded credit cards to new and existing customers. Circuit City is compensated under the program agreement primarily based on the number of new accounts opened less promotional financing costs that exceed a negotiated base amount. The net results from the program agreement are included in net sales on the consolidated statements of operations.

Discontinued Operations

On January 28, 2007, in accordance with the Amending Agreement dated March 27, 2004, Rogers Wireless Inc. terminated its agreement with InterTAN Canada Ltd. with respect to the operation of the Rogers Plus® stores in the international segment. Results from the Rogers Plus® stores are presented as results from discontinued operations on the consolidated statements of operations.

The company closed a domestic segment operation in fiscal 2007 that previously had been held for sale. The company sold a domestic segment subsidiary, MusicNow, LLC, in fiscal 2006. Results from these operations are presented as results from discontinued operations on the consolidated statements of operations.

Available Information

Circuit City makes available, free of charge on its Web site, its Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to those reports as soon as practicable after electronically filing the material with or furnishing the material to the Securities and Exchange Commission. These documents may be viewed by visiting the company s investor information Web site at http://investor.circuitcity.com and selecting the SEC Filings link under the Investor Information header.

The company also makes available, free of charge on its Web site, the charters of the Audit Committee, Nominating and Governance Committee, and Compensation and Personnel Committee as well as the global code of business conduct and the corporate governance guidelines adopted by the board of directors. These documents may be viewed by visiting the investor information Web site at http://investor.circuitcity.com, and selecting the desired information under the Corporate Governance header. The company intends to satisfy any disclosure obligations with respect to amendments or waivers of the global code of business conduct by posting the information on the company s investor Web site.

References to the company s Web site do not constitute incorporation by reference of the information contained on the Web site, and the information contained on the Web site is not part of this document.

Item 1A. Risk Factors.

Our business is influenced by many factors that are difficult to predict, involve risks or uncertainties that may materially affect actual results and are often beyond our control. Understanding how these factors may affect our business is important to understanding information about the company in this Annual Report on Form 10-K and our other filings and releases. Our discussion below contains forward-looking statements, as discussed in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations (MD&A). You should read the discussion below in conjunction with our MD&A, and the consolidated financial statements and related notes included in this report.

Failure to improve our cost and expense structure could have a material adverse impact on our profitability and earnings.

The average selling prices of key products, including flat panel televisions, have decreased significantly which makes it more challenging for us to maintain or grow profit margins on these products. Many of our competitors have been able to leverage sales growth and maintain efficient cost structures. We have taken actions to improve our cost and expense structure and continue to look for ways to more cost-effectively deliver our products and services to customers. Our strategies for growing revenues will require investments in information technology, innovation and real estate, which could make it difficult for us to achieve or maintain cost reductions. Unplanned increases in labor rates, advertising and marketing expenses or indirect spending could have a material adverse impact on our profitability and operating results.

We face intense, multi-channel competition from a variety of competitors that could negatively impact our financial performance.

In order to achieve profitable results, we must compete successfully in the consumer electronics industry against large specialty retailers, discount or warehouse retailers, home office retailers, Internet-based retailers, direct-to-consumer alternatives and local or regional retailers. Many of our vendors and suppliers have opened retail store locations and increased their direct sales to consumers. Because of the size and strong performance of some of our competitors, they may promote merchandise more aggressively and offer more attractive financing and discount prices for extended periods of time, which could adversely affect our profit margin. If we cannot respond adequately to these multiple sources and types of competition, it could adversely impact customer traffic, market share and overall financial performance.

If we are not successful in growing our services platform and increasing sales of services and accessories, then our margin and revenues could be adversely impacted.

Our strategy includes sales and revenue growth from services, including home theater installation and services for personal computers. We also are focused on increasing revenues through solution selling where we provide the customer with key products as well as cables, connectors, brackets, batteries, chargers, stands, mounts and other accessories. If we are unable to increase the rates at which our customers purchase these services and accessories, then our margin rates could be negatively impacted by decreases in average retail prices. In addition, our revenues could be adversely impacted as a larger number of competitors are able to sell products online and through discount retail channels.

We may not be able to attract and retain qualified Associates at all levels within the company, which could adversely affect our sales performance, cost structure and competitive position within the industry.

We must recruit and retain a large number of qualified Associates in order to perform successfully. We face intense competition for Associates at all levels of the company, and we compete in job markets nationally. Many of our Associates are in entry-level or part-time positions, which typically have high levels of turnover. Our ability to maintain appropriate staffing levels while controlling labor costs is subject to a number of external factors such as the quality of the labor market in our trade areas, unemployment levels, prevailing wages, changing demographics, health insurance costs and state labor and employment requirements. If we are unable to attract and retain qualified Associates, then our sales performance may be adversely impacted or our labor costs may increase significantly. We have taken steps to bring our hourly wages in line with the marketplace, which could have an adverse impact on morale, productivity, recruiting and retention. In addition, we have made a number of management changes focused on improving the level of talent at the management and executive levels within the company. If we are unable to retain key managers and executives, then it may be difficult for us to maintain a competitive position within the industry or to implement strategic changes in the future.

Failure to effectively manage our inventory levels could adversely affect our financial results.

We rely on a best sourcing strategy where we procure merchandise from a variety of sources and methods, including new and existing vendors, reverse auctions, global sourcing capability within the company and direct relationships with manufacturers. We depend on strong and stable supplier relationships and accurate forecasts of customer demand. Reduced consumer spending or lack of consumer interest in our products could lead to excess inventory levels; alternatively, if we do not have adequate inventory to respond to customer demand for products, we may lose sales to competitors. Additionally, we may inaccurately forecast product life cycles or end-of-life products, leaving us with excess inventory. As a result, we may be forced to lower our prices, adversely impacting margins and financial results.

We may be unable to relocate successfully or open new stores in desirable locations, which could adversely affect our ability to increase sales and achieve profitable growth.

Our store revitalization program is an important part of our business plan. We have a significant number of stores in older formats or in locations where the trade area has shifted away from our target market. We continue to refine our store prototypes and seek real estate in smaller trade areas and urban locations in addition to larger markets. When we open new stores in markets where we already have a presence, our existing locations may experience a decline in sales as a result. For our store revitalization program to be successful, we must identify and lease favorable store sites, construct the building, and hire and train Associates for the new location. In many locations, we face intense competition from other retailers for both real estate and qualified Associates. Construction, environmental, zoning and real estate delays may negatively impact store openings and increase costs and capital expenditures. We cannot be certain that new or relocated stores will produce the anticipated sales or return on investment or that existing stores will not be adversely affected by new or expanded competition in their market areas.

Consumers may not upgrade televisions or buy related audio products, home theater products or services at the rate we expect during the next few years, which would adversely affect our growth, revenues and margins.

Because of the transition from analog to digital television broadcasting, we have invested significant inventory, store space and labor in the advanced television category. We expect a large number of consumers to replace analog television sets in the next few years and to purchase related audio products, home theater products and services at the same time. Set-top converters and other technology will permit consumers to continue to use analog televisions even after broadcasting is converted to a digital signal. As a result, if consumers do not embrace advanced television at the levels we expect, our growth, revenues and margins may be negatively impacted.

We may not be able to successfully execute our multi-channel marketing strategy, which could adversely affect our growth, revenues and margins.

Our direct-to-consumer business has grown rapidly since the launch of our Web site in 1999. We have invested heavily in marketing our in-store pickup process for Web orders, and we have initiated a catalog offering that allows consumers to order products by phone. These efforts are intended to attract new customers and increase sales from existing customers, but they could result in customers making fewer trips to our brick-and-mortar stores. It may be more challenging for us to increase sales of extended warranties, services and accessories as customers move toward greater online shopping. In addition, competitive pricing on the Internet and the ability of online customers to perform better price comparisons could negatively impact traffic, average purchase amount and profit margins.

Our business is heavily dependent upon information systems, which require upgrades that may be expensive or difficult to implement, and which could result in higher costs and business disruption.

Our information systems include in-store point-of-sale systems that provide information used to track sales performance by Associates, inventory replenishment, e-commerce product availability, product margin information and customer information. In addition, we have or are implementing systems for data warehousing; merchandising and supply chain; planning; and marketing. These systems are complex and require integration with each other and with business processes. We have outsourced a large portion of our information technology infrastructure operations to IBM. If IBM does not respond to our needs or provide satisfactory levels of service under this arrangement, or if we encounter difficulty implementing new systems or maintaining and upgrading current systems, then our business operations could be disrupted and our expenses could increase.

Our business is subject to quarterly fluctuations and seasonality, which leaves our financial and operating results vulnerable to temporary unfavorable conditions that may impact key selling periods.

The most significant portion of our revenue is generated during the period that begins with Thanksgiving, includes the holiday shopping season and continues until the Super Bowl. The majority of this period occurs in the company s fourth fiscal quarter. As a result, any factors negatively affecting us during this time of year, including

Table of Contents

adverse weather or unfavorable economic conditions, could have a material adverse impact on our revenue and profitability for the entire year. In addition, other key holiday weekends during the year, such as Memorial Day, Fourth of July and Labor Day, bring disproportionately high revenues for the quarter in which they fall, relative to non-holiday weekends, and also leave us somewhat vulnerable to adverse impacts from temporary unfavorable conditions.

General economic conditions or a decline in consumer discretionary spending may adversely impact our sales in a disproportionate fashion.

We sell products and services that consumers tend to view as conveniences rather than necessities. As a result, our results of operations are more sensitive to changes in general economic conditions that impact consumer spending, including discretionary spending. Future economic conditions such as employment levels, business conditions, interest rates, energy costs and tax rates could reduce consumer spending or change consumer purchasing habits. A general reduction in the level of consumer spending or our inability to respond to shifting consumer attitudes regarding products, store locations and other factors could adversely affect our growth and profitability.

We may not be able to anticipate and respond to changes in consumer demand, preferences and patterns, which could adversely affect our sales and profitability.

The consumer electronics industry is subject to rapid technological change, obsolescence and price erosion. Our success depends on our ability to anticipate and respond to consumer demand and preferences for new items. The introduction and availability of new products are often controlled by manufacturers and may be subject to the cooperation of third parties such as television broadcasters and wireless providers. We may be adversely impacted by limited quantities of new products. The introduction of new technologies may negatively impact sales of existing products. Significant deviations from the projected demand for products we sell could result in lost sales or lower margins due to the need to mark down excess inventory.

Our innovation and strategy efforts may fail to increase sales, improve margins or enhance the customer experience and may not result in any meaningful differentiation against our competitors, which could adversely affect our ability to achieve profitable growth.

We have instituted an innovation process to define and test strategic initiatives to grow business in key areas and to identify future areas of growth for us. As a result of this innovation process, we are making large investments in training, information systems and store formats that could prove to be unsustainable or unprofitable when rolled out on a national scale. This could negatively impact our expense structure and profitability. Our failure to successfully implement our strategic vision or the occurrence of any of the following events could have a material adverse impact on our business:

- Inability to provide a superior customer experience in our stores that is differentiated from our competitors
- Failure to leverage our assets to create new revenue streams and profit
- Failure to identify customer needs and desires and to tailor our shopping experience in a way that meets these needs
- Inability to grow revenue through in-home sales and service offerings
- Lack of core competencies, talent and systems needed to sustain growth and support innovation efforts

We rely on foreign sources for a significant portion of our merchandise, so disruptions in countries where our goods are produced or international trade or transportation issues could adversely affect availability of key products and result in associated declines in revenues.

We depend on products produced outside the United States and Canada. We could be adversely affected by a number of risks associated with production and delivery of those products into our market areas, including

Economic or political instability, natural disasters or public health emergencies in countries where our suppliers are located;

Table of Contents

Increases in shipping costs;

Transportation delays or interruptions, particularly as they may affect seasonal periods; and

Changes in laws or taxation policies as they may affect the import and export of goods.

Ite m 1B. Unresolved Staff Comments.
None.

Table of Contents

Item 2. Properties.

The following table summarizes the geographic location of the company s retail stores and dealer out