

Edgar Filing: BOOKS A MILLION INC - Form 10-Q

BOOKS A MILLION INC  
Form 10-Q  
December 13, 2005

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q

(MARK ONE)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.

For the quarterly period ended: October 29, 2005

- 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 0-20664

BOOKS-A-MILLION, INC.  
-----

(Exact name of registrant as specified in its charter)

DELAWARE  
-----

(State or other jurisdiction of  
incorporation or organization)

63-0798460  
-----

(IRS Employer Identification No.)

402 INDUSTRIAL LANE, BIRMINGHAM, ALABAMA  
-----

(Address of principal executive offices)

35211  
-----

(Zip Code)

(205) 942-3737  
-----

(Registrant's phone number including area code)

NONE  
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(Former name, former address and former fiscal year, if changed since last period)

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  No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes [ ] No [X]

Indicate the number of shares outstanding of each of the issuer's common stock, as of the latest practicable date: Shares of common stock, par value \$.01 per share, outstanding as of December 6, 2005 were 16,524,930 shares.

### BOOKS-A-MILLION, INC. AND SUBSIDIARIES

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#### PART 1. FINANCIAL INFORMATION ITEM 1. FINANCIAL STATEMENTS BOOKS-A-MILLION, INC. & SUBSIDIARIES

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CONDENSED CONSOLIDATED BALANCE SHEETS  
(DOLLARS IN THOUSANDS EXCEPT PER SHARE AND SHARE AMOUNTS)

AS OF OCTOBER 29,  
(UNAUDITED)  
-----

ASSETS

CURRENT ASSETS:

Cash and cash equivalents	\$ 5,070
Accounts receivable, net	7,725
Related party accounts receivable, net	423
Inventories	226,849
Prepayments and other	3,774
Deferred income taxes	2,369

TOTAL CURRENT ASSETS 246,210  
-----

PROPERTY AND EQUIPMENT:

Gross property and equipment	202,470
Less accumulated depreciation and amortization	(149,397)

NET PROPERTY AND EQUIPMENT 53,073  
-----

OTHER ASSETS

Deferred income taxes	1,081
Other assets	2,972

TOTAL OTHER ASSETS 4,053  
-----

TOTAL ASSETS \$ 303,336  
=====

LIABILITIES AND STOCKHOLDERS' EQUITY

CURRENT LIABILITIES:

Accounts payable	\$ 102,595
Related party accounts payable	3,934
Accrued expenses	35,601
Accrued income taxes	-

TOTAL CURRENT LIABILITIES 142,130  
-----

LONG-TERM DEBT

DEFERRED INCOME TAXES	14,740
OTHER LONG-TERM LIABILITIES	-

TOTAL NON-CURRENT LIABILITIES 11,348  
-----

COMMITMENTS AND CONTINGENCIES (NOTE 6)

STOCKHOLDERS' EQUITY:

Preferred stock, \$.01 par value, 1,000,000 shares authorized, no shares outstanding	-
Common stock, \$.01 par value, 30,000,000 shares authorized, 19,510,276 and 19,067,960 shares issued at October 29, 2005 and January 29, 2005, respectively	195
Additional paid-in capital	78,420
Less treasury stock, at cost (2,992,846 and 2,792,869	

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shares at October 29, 2005 and January 29, 2005, respectively)	(14,341)
Deferred compensation	(1,003)
Accumulated other comprehensive loss, net of tax	(64)
Retained earnings	71,911
	-----
TOTAL STOCKHOLDERS' EQUITY	135,118
	-----
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 303,336
	=====

SEE ACCOMPANYING NOTES

BOOKS-A-MILLION, INC. & SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)  
(UNAUDITED)

	THIRTEEN WEEKS ENDED		THI
	OCTOBER 29, 2005	OCTOBER 30, 2004	OCTOB
NET SALES	\$ 107,638	\$ 104,072	\$
Cost of products sold (including warehouse distribution and store occupancy costs)	79,491	76,247	
	-----	-----	
GROSS PROFIT	28,147	27,825	
Operating, selling and administrative expenses	26,521	24,748	
Gain on insurance recovery (Note 11)	1,248	-	
Depreciation and amortization	3,889	4,394	
	-----	-----	
OPERATING INCOME (LOSS)	(1,015)	(1,317)	
Interest expense, net	379	503	
	-----	-----	
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	(1,394)	(1,820)	
Income taxes provision (benefit)	(534)	(674)	
	-----	-----	
INCOME (LOSS) FROM CONTINUING OPERATIONS	(860)	(1,146)	
DISCONTINUED OPERATIONS (NOTE 10)			
Loss from discontinued operations before income taxes	(21)	(41)	
Income tax benefit	8	15	
	-----	-----	
LOSS FROM DISCONTINUED OPERATIONS	(13)	(26)	
	-----	-----	
NET INCOME (LOSS)	\$ (873)	\$ (1,172)	\$
	=====	=====	=====

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NET INCOME PER COMMON SHARE:

BASIC:

INCOME (LOSS) FROM CONTINUING OPERATIONS	\$ (0.05)	\$ (0.07)	\$
LOSS FROM DISCONTINUED OPERATIONS	--	--	--
NET INCOME (LOSS)	\$ (0.05)	\$ (0.07)	\$

WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING -  
BASIC

16,487	16,578
--------	--------

DILUTED:

INCOME (LOSS) FROM CONTINUING OPERATIONS	\$ (0.05)	\$ (0.07)	\$
LOSS FROM DISCONTINUED OPERATIONS	-	-	-
NET INCOME (LOSS)	\$ (0.05)	\$ (0.07)	\$

WEIGHTED AVERAGE NUMBER OF SHARES  
OUTSTANDING -  
DILUTED

16,487	16,578
--------	--------

DIVIDENDS PER SHARE - DECLARED

\$ 0.05	\$ 0.15
---------	---------

SEE ACCOMPANYING NOTES

BOOKS-A-MILLION, INC. & SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY  
(DOLLARS IN THOUSANDS)  
(UNAUDITED)

(in thousands)	Common Stock		Additional Paid-In Capital	Treasury Stock		Deferred Compensation		Retained Earnings
	Shares	Amount		Shares	Amount	Shares	Amount	
BALANCE JANUARY 29, 2005	19,068	\$191	\$ 74,505	2,793	\$ (11,630)	-	\$ (481)	\$ 72,469
Net income								1,888
Unrealized gain on accounting for derivative instruments, net of tax provision of \$71								
Subtotal comprehensive								

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income								
Purchase of treasury stock				200	(2,711)			
Dividends paid								(2,446)
Issuance of restricted stock	40			809			(809)	
Amortization of deferred compensation related to restricted stock							287	
Issuance of stock for employee stock purchase plan	13			83				
Exercise of stock options	389	4		2,632				
Tax benefit from exercise of stock options				391				
BALANCE OCTOBER 29, 2005	19,510	\$195	\$ 78,420	2,993	\$(14,341)	-	\$(1,003)	\$ 71,911

BOOKS-A-MILLION, INC. & SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(DOLLARS IN THOUSANDS)  
(UNAUDITED)

	THIRTY-NINE WEEKS ENDED	
	OCTOBER 29, 2005	OCTOBER 30, 2004
	-----	-----
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 1,888	\$ 1,000
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	11,925	13,300
Deferred (compensation) amortization	287	1,000
Loss on impairment of assets	210	1,000
(Gain)/Loss on disposal of property	1	(1,000)
Change in deferred income taxes	(3,161)	1,000
Increase in inventories	(16,579)	(16,900)
Increase in accounts payable	2,835	12,800
Changes in certain other assets and liabilities	(4,184)	(6,300)
Total adjustments	(8,666)	3,300

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Net cash provided by (used in) operating activities	(6,778)	4,4
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(9,521)	(7,0
Proceeds from sale of equipment	8	
Net cash used in investing activities	(9,513)	(6,9
CASH FLOWS FROM FINANCING ACTIVITIES:		
Borrowings under credit facilities	146,650	143,4
Repayments under credit facilities	(139,410)	(136,1
Purchase of treasury stock	(2,711)	(3,9
Proceeds from sale of common stock, net	2,719	1,0
Payment of dividends	(2,446)	(2,5
Net cash provided by financing activities	4,802	1,8
Net increase (decrease) in cash and cash equivalents	(11,489)	(6
Cash and cash equivalents at beginning of period	16,559	5,3
Cash and cash equivalents at end of period	\$ 5,070	\$ 4,6
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the thirty-nine week period for:		
Interest	\$ 1,206	\$ 1,5
Income taxes, net of refunds	\$ 6,387	\$ 4,4

SEE ACCOMPANYING NOTES

BOOKS-A-MILLION, INC. AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)

1. BASIS OF PRESENTATION

The unaudited condensed consolidated financial statements of Books-A-Million, Inc. and its subsidiaries (the "Company") for the thirteen and thirty-nine week periods ended October 29, 2005 and October 30, 2004 have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and are presented in accordance with the requirements of Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto for the fiscal year ended January 29, 2005 included in our Fiscal 2005 Annual Report on Form 10-K. In the opinion of management, the financial statements included herein contain all adjustments considered necessary for a fair presentation of our financial position as of October 29, 2005, and the results of its operations and cash flows for the thirteen and thirty-nine week periods ended October 29, 2005 and October 30, 2004, respectively. Certain prior year amounts have been reclassified to conform to current year presentation.

The preparation of financial statements in conformity with GAAP requires

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management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual amounts could differ from those estimates and assumptions.

We have also experienced, and expect to continue to experience, significant variability in sales and net income from quarter to quarter. Therefore, the results of the interim periods presented herein are not necessarily indicative of the results to be expected for any other interim period or the full year.

### Stock-Based Compensation

On June 1, 2005, the stockholders of the Company approved the adoption of the Books-A-Million, Inc. 2005 Incentive Award Plan. The Company's board of directors had previously approved this plan subject to stockholder approval. An aggregate of 300,000 shares of common stock may be issued pursuant to awards granted under the Plan. On June 29, 2005 the Company granted 77,100 shares of restricted stock to the Company's officers and key employees pursuant to the terms of the Plan. Additionally, the Company granted 3,333 shares of restricted stock to a Director that joined the Company's Board of Directors in August 2005. The compensation expense related to these grants is being expensed over the vesting period for the individual grants. In the thirteen and thirty-nine weeks ended October 29, 2005, the Company has recorded \$54,454 and \$157,768, respectively, of stock-based compensation expense for the restricted stock grants.

The Company has a stock option plan that provides for the issuance of options to employees and members of the board of directors. Upon the approval of the 2005 Incentive Award Plan by our stockholders at the Company's annual meeting, we determined that there will be no additional awards made under the Company's stock option plan. The Company accounts for the plan under the recognition and measurement principles of Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees" and related Interpretations. No stock-based employee compensation cost for this plan is reflected in net income, as all options granted under the plan had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net income and net income per common share if the Company were to apply the fair value recognition provisions of Statement of Financial Accounting Standards No. 148 ("SFAS 148") "Accounting for Stock-Based Compensation -- Transaction and Disclosure -- an Amendment of FASB Statement No. 123," to stock-based employee compensation (in thousands except per share amounts):

BOOKS-A-MILLION, INC. AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)

	For the Thirteen Weeks Ended		For the Thirty-Nine Weeks	
In thousands	October 29, 2005	October 30, 2004	October 29, 2005	October 30, 2004
Net income (loss), as reported	\$ (873)	\$ (1,172)	\$ 1,888	\$ 1,888
Add: Stock-based employee compensation expense included in				



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reported net income				
(loss), net of related tax	64	25	177	
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of tax effects	202	366	591	1
Pro forma net income (loss)	\$ (1,011)	\$ (1,513)	\$ 1,474	\$
Net income (loss) per common share:				
Basic -- as reported	\$ (0.05)	\$ (0.07)	\$ 0.12	\$
Basic -- pro forma	\$ (0.06)	\$ (0.09)	\$ 0.09	\$
Diluted -- as reported	\$ (0.05)	\$ (0.07)	\$ 0.11	\$
Diluted -- pro forma	\$ (0.06)	\$ (0.09)	\$ 0.09	\$

There were no new grants of stock options in fiscal 2006. Stock-based compensation expense reflected in the above table for fiscal 2006 relates to options granted in prior years that would be expensed over their vesting period. The fair value of the options granted under the Company's stock option plan for fiscal 2005 was estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions: \$0.03 per quarter dividend yield; expected stock price volatility rate of 0.44; risk-free interest rates of 3.45% to 4.31%; and expected lives of six or ten years.

2. NET INCOME (LOSS) PER SHARE

Basic net income (loss) per share ("EPS") is computed by dividing income (loss) available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock are exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Company. Diluted EPS has been computed based on the weighted average number of shares outstanding including the effect of outstanding stock options and restricted stock, if dilutive, in each respective thirteen and thirty-nine week period. A reconciliation of the weighted average shares for basic and diluted EPS is as follows:

	For the Thirteen Weeks Ended	
	(in thousands)	
	October 29, 2005	October 30, 2004
	-----	-----
Weighted average shares outstanding:		
Basic	16,487	16,578
Dilutive effect of stock options and restricted stock outstanding	-	-
	-----	-----
Diluted	16,487	16,578
	=====	=====

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	For the Thirty-Nine Weeks Ended (in thousands)	
	October 29, 2005	October 30, 2004
Weighted average shares outstanding:		
Basic	16,329	16,507
Dilutive effect of stock options and restricted stock outstanding	595	720
	-----	-----
Diluted	16,924	17,227
	=====	=====

BOOKS-A-MILLION, INC. AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)

Options outstanding to purchase 24,500 and 796,000 shares of common stock as of October 29, 2005 and October 30, 2004, respectively, were not included in the table above as they were anti-dilutive under the treasury stock method.

### 3. RELATED PARTY TRANSACTIONS

Charles C. Anderson, a former director of the Company, Terry C. Anderson, a director of the Company, and Clyde B. Anderson, a director and officer of the Company, have controlling ownership interests in other entities with which the Company conducts business. Significant transactions between the Company and these various other entities ("related parties") are summarized in the following paragraphs.

The Company purchases a substantial portion of its magazines as well as certain of their seasonal music and newspapers from Anderson Media Corporation ("Anderson Media"), an affiliate through common ownership. During the thirteen and thirty-nine weeks ended October 29, 2005 purchases of these items from Anderson Media totaled \$12,485,000 and \$25,425,000, respectively, compared to \$8,708,000 and \$24,645,000 during the same periods last year. The Company purchases certain of its collectibles and books from Anderson Press, Inc. ("Anderson Press"), an affiliate through common ownership. During the thirteen and thirty-nine weeks ended October 29, 2005, such purchases from Anderson Press totaled \$505,000 and \$1,162,000, respectively, compared to \$355,000 and \$580,000 during the same periods last year. The Company purchases certain of its greeting cards and gift products from C.R. Gibson, Inc. ("C.R. Gibson"), an affiliate through common ownership. The purchases of these products from C.R. Gibson during the thirteen and thirty-nine weeks ended October 29, 2005 were \$22,000 and \$156,000, respectively, compared to \$48,000 and \$278,000 during the same periods last year. The Company purchases certain magazine subscriptions from Magazines.com, an affiliate through common ownership. During the thirteen and thirty-nine weeks ended October 29, 2005, purchases of these items from Magazines.com were \$17,000 and \$44,000, respectively, compared to \$16,000 and \$53,000 in the same periods last year. The Company purchases content for publication from Publication Marketing Corporation ("Publication Marketing"), an affiliate through common ownership. During the thirteen and thirty-nine weeks ended October 29, 2005, purchases of these items from Publication Marketing were \$24,000 and \$53,000, respectively, compared to \$27,000 and \$51,000 during the same periods last year. The Company utilizes import sourcing and consolidation services from Anco Far East Importers, LTD ("Anco Far East"), an affiliate through common ownership. The total paid to Anco Far East was \$370,000 and

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\$1,768,000 during the thirteen and thirty-nine weeks ended October 29, 2005, respectively, compared to \$583,000 and \$905,000 during the same periods last year. These amounts paid to Anco Far East primarily included the actual cost of the product as well as fees for sourcing and consolidation services. All costs other than the sourcing and consolidation service fees were passed through from other vendors. Anco Far East fees, net of the passed-through costs, were \$26,000 and \$124,000 during the thirteen and thirty-nine weeks ended October 29, 2005, respectively, compared to \$41,000 and \$63,000 during the same periods last year.

The Company sold books to (received returns from) Anderson Media in the amounts of \$233,000 and \$239,000 during the thirteen and thirty-nine weeks ended October 29, 2005, respectively, compared to (\$47,000) and (\$78,000) during the same periods last year. During the thirteen and thirty-nine weeks ended October 29, 2005, the Company provided \$0 and \$7,000, respectively, of internet services to Magazines.com, compared to \$206,000 and \$253,000 during the same periods last year. The Company provided internet services to American Promotional Events, an affiliate through common ownership, of \$6,000 and \$69,000 during the thirteen and thirty-nine weeks ended October 29, 2005, respectively, compared to \$8,000 and \$62,000 during the same periods last year.

The Company leases its principal executive offices from a trust, beneficiaries of which are the grandchildren of Mr. Charles C. Anderson, a former member of the Board of Directors. The lease extends to January 31, 2006. During the thirteen and thirty-nine weeks ended October 29, 2005, the Company paid rent of \$34,000 and \$103,000, respectively, to the trust under this lease compared to \$34,000 and \$103,000 during the same periods last year. Anderson & Anderson LLC ("A&A"), an affiliate through common ownership, also leases three buildings to the Company. During the thirteen and thirty-nine weeks ended October 29, 2005, the Company paid A&A a total of \$111,000 and \$333,000, respectively, in connection with such leases compared to \$110,000 and \$331,000 during the same periods last year. Total minimum future rental payments under all of these leases are \$34,000 at October 29, 2005. The Company subleases certain property to Hibbett Sporting Goods, Inc. ("Hibbett"), a sporting goods retailer in the southeastern United States. The Company's Executive Chairman, Clyde B. Anderson, is a member of Hibbett's board of directors. During the thirteen and thirty-nine weeks ended October 29, 2005, the Company received \$62,000 and \$157,000, respectively, in rent payments from Hibbett compared to \$48,000 and \$143,000 during the same periods last year.

The Company shares ownership of a plane, which the Company uses in the operation of its business, with an affiliated company. The Company rents the plane to affiliated companies at rates that cover all of the variable cost

### BOOKS-A-MILLION, INC. AND SUBSIDIARIES NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

and a portion of the fixed cost of the plane. The total amounts received from affiliated companies for use of the plane during the thirteen and thirty-nine weeks ended October 29, 2005 were \$82,000 and \$238,000, respectively, compared to \$13,000 and \$144,000 during the same periods last year. The Company also occasionally rents a plane from A&A as well. The amounts paid to A&A for plane rental were \$4,000 and \$35,000 for the thirteen and thirty-nine weeks ended October 29, 2005, respectively compared to \$6,000 and \$22,000 during the same periods last year.

#### 4. DERIVATIVE AND HEDGING ACTIVITIES

The Company is subject to interest rate fluctuations involving its credit facilities and debt related to an industrial development revenue bond (the

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"Bond"). However, the Company uses fixed interest rate hedges to manage a portion of this exposure. The Company entered into two separate \$10 million interest rate swaps on July 24, 2002 (the "Credit Facility Hedges"), which effectively fixed the interest rate on \$20 million of variable credit facility debt at 5.13%. Both of the Credit Facility Hedges expired in August 2005, and the Company has not replaced the Credit Facility Hedges. In addition, the Company entered into a \$7.5 million interest rate swap in May 1996 that expires in June 2006 and effectively fixes the interest rate on the Bond at 8.73% (the "Bond Hedge"). The counterparty to the Bond Hedge is a primary bank in the Company's credit facility. The Company believes the credit and liquidity risk of the counter party failing to meet its obligation under the Bond Hedge is remote.

The Bond Hedge is a cash flow hedge, and until the fourth quarter of fiscal 2004 and the fourth quarter of fiscal 2005, respectively, the Credit Facility Hedges were cash flow hedges. Cash flow hedges protect against the variability in future cash outflows of current or forecasted debt and related interest expense. The changes in the fair value of these hedges are reported on the balance sheet with a corresponding adjustment to accumulated other comprehensive income (loss) or in earnings, depending on the type of hedging relationship. Over time, amounts held in accumulated other comprehensive income (loss) will be reclassified to earnings if the hedge transaction becomes ineffective.

The Company's interest rate swaps described above are reported as liabilities classified in other long-term liabilities in the accompanying condensed consolidated balance sheets at their fair value of \$150,000 and \$543,000 as of October 29, 2005 and January 29, 2005, respectively. For the thirteen weeks ended October 29, 2005 and October 30, 2004, respectively, adjustment gains of \$21,000 (net of tax provision of \$12,000) and \$72,000 (net of tax provision of \$42,000), respectively, and in the thirty-nine weeks ended October 29, 2005 and October 30, 2004, adjustment gains of \$130,000 (net of tax provision of \$85,000) and \$298,000 (net of tax provision of \$175,000), respectively, were recorded as unrealized gains in accumulated other comprehensive income (loss) and are detailed in Note 5. During the fourth quarter of fiscal 2004, one of the Credit Facility Hedges no longer qualified for hedge accounting under SFAS No. 133, and the Company de-designated the hedge at that time. In addition, in the fourth quarter of fiscal 2005, the other Credit Facility Hedge no longer qualified for hedge accounting under SFAS No. 133, and the Company de-designated that hedge at that time. For the thirteen weeks ended October 29, 2005 and October 30, 2004, pre-tax gains of \$30,000 and \$34,000, respectively, were recorded in earnings related to the de-designated hedges. For the thirty-nine weeks ended October 29, 2005 and October 30, 2004, pre-tax gains of \$178,000 and \$213,000, respectively, were recorded in earnings related to the de-designated hedges.

### BOOKS-A-MILLION, INC. AND SUBSIDIARIES NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

#### 5. COMPREHENSIVE INCOME

Comprehensive income is net income plus certain other items that are recorded directly to stockholders' equity. The only such items currently applicable to the Company are the unrealized gains (losses) on the hedges explained in Note 4, as follows:

Thirteen Weeks Ended  
-----

Thirty-Nine W  
-----

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	(in thousands)		(in thou
COMPREHENSIVE INCOME (LOSS)	October 29, 2005	October 30, 2004	October 29, 2005
Net Income (Loss)	\$(873)	\$(1,172)	\$1,888
Unrealized gains (losses) on hedges, net of deferred tax provision (benefit) for the thirteen-week periods of \$12 and \$42, respectively, and the thirty-nine week periods of \$84 and \$175, respectively.	21	72	131
Total comprehensive income (loss)	\$(852)	\$(1,100)	\$2,019

### 6. COMMITMENTS AND CONTINGENCIES

The Company is a party to various legal proceedings incidental to its business. In the opinion of management, after consultation with legal counsel, the ultimate liability, if any, with respect to those proceedings is not presently expected to materially affect the financial position, results of operations or cash flows of the Company.

From time to time, the Company enters into certain types of agreements that require the Company to indemnify parties against third party claims under certain circumstances. Generally these agreements relate to: (a) agreements with vendors and suppliers under which the Company may provide customary indemnification to its vendors and suppliers in respect of actions they take at the Company's request or otherwise on its behalf; (b) agreements to indemnify vendors against trademark and copyright infringement claims concerning books published or merchandise manufactured specifically for or on behalf of the Company; (c) real estate leases, under which the Company may agree to indemnify the lessors from claims arising from the Company's use of the property; and (d) agreements with the Company's directors, officers and employees, under which the Company may agree to indemnify such persons for liabilities arising out of their relationship with the Company. The Company has directors and officers liability insurance, which, subject to the policy's conditions, provides coverage for indemnification amounts payable by the Company with respect to its directors and officers up to specified limits and subject to certain deductibles.

The nature and terms of these types of indemnities vary. The events or circumstances that would require the Company to perform under these indemnities are transaction and circumstance specific. Generally, the Company's maximum liability under such indemnities is not explicitly stated, and, therefore, the overall maximum amount of the Company's obligations cannot be reasonably estimated. Historically, the Company has not incurred significant costs related to performance under these types of indemnities. No liabilities have been recorded for these obligations on the Company's balance sheet at October 29, 2005 and January 29, 2005 as such liabilities are considered de minimis.

### 7. INVENTORIES

Inventories were:

(In thousands)	October 29, 2005	January 29, 2005
----------------	------------------	------------------

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Inventories (at FIFO)	\$228,366	\$211,375
LIFO reserve	(1,517)	(1,105)
Net inventories	\$226,849	\$210,270

BOOKS-A-MILLION, INC. AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)

8. BUSINESS SEGMENTS

The Company has two reportable segments, retail trade and electronic commerce trade. The retail trade segment is a strategic business segment that is engaged in the retail trade of mostly book merchandise and includes the Company's distribution center operations, which supplies merchandise primarily to the Company's retail stores. The electronic commerce trade segment is a strategic business segment that transacts business over the internet and is managed separately due to divergent technology and marketing requirements.

The accounting policies of the segments are substantially the same as those described in the Company's Fiscal 2005 Annual Report on Form 10-K. The Company evaluates performance of the segments based on net income from operations before interest and income taxes. Certain intersegment cost allocations have been made based upon consolidated and segment revenues.

SEGMENT INFORMATION (IN THOUSANDS)	Thirteen Weeks Ended		Thirty-Ni
	October 29, 2005	October 30, 2004	October 29, 2005
<b>NET SALES</b>			
Retail Trade	\$ 105,434	\$ 101,965	\$ 337,656
Electronic Commerce Trade	6,807	6,571	19,987
Intersegment Sales Elimination	(4,603)	(4,464)	(14,583)
Net Sales	\$ 107,638	\$ 104,072	\$ 343,060
<b>OPERATING INCOME (LOSS)</b>			
Retail Trade	\$ (1,407)	\$ (1,773)	\$ 3,844
Electronic Commerce Trade	478	408	650
Intersegment Elimination of Certain Costs	(86)	48	(188)
Total Operating Income (Loss)	\$ (1,015)	\$ (1,317)	\$ 4,306

As of  
October 29, 2005      As of  
January 29, 2005

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ASSETS

Retail Trade	\$ 301,748	\$ 296,622
Electronic Commerce Trade	1,698	1,372
Intersegment Asset Elimination	(110)	(263)
	-----	-----
Total Assets	\$ 303,336	\$ 297,731
	=====	=====

BOOKS-A-MILLION, INC. AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)

9. RECENT ACCOUNTING PRONOUNCEMENTS

In December 2004, the Financial Accounting Standards Board ("FASB") issued SFAS No. 123R (revised 2004, "Share-Based Payment"). SFAS No. 123R is a revision of SFAS No. 123, "Accounting for Stock-Based Compensation" and supersedes ABP Opinion No. 25, "Accounting for Stock Issued to Employees." SFAS No. 123R requires all share-based payments to employees and directors, including grants of employee stock options, to be recognized in the financial statements based on their fair values. SFAS No. 123R is effective at the beginning of the first annual period beginning after June 15, 2005 (as modified by the SEC on April 14, 2005). Under ABP Opinion No. 25, no stock-based compensation cost has been reflected in the net income of the Company for grants of stock options to employees. Beginning in fiscal 2007, the Company will recognize compensation expense in its financial statements based on the fair value of all share-based payments to employees. The Company is currently determining the impact of adopting this new accounting standard on the Company's financial position, results of operations and cash flows.

In November 2004, the Emerging Issues Task Force ("EITF") issued EITF No. 03-13 "Applying the Conditions in Paragraph 42 of FASB No. 144 in Determining Whether to Report Discontinued Operations." EITF No. 03-13 addresses how an ongoing entity should evaluate whether the operations and cash flows of a disposed component have been or will be eliminated from the ongoing operations of the entity and the types of continuing involvement that constitute significant continuing involvement in the operations of the disposed component. EITF No. 03-13 is effective beginning in fiscal 2006. The adoption of this EITF did not have a material effect on the Company's financial position, results of operations or cash flows.

FASB Interpretation (FIN) No. 46 "Consolidation of Variable Interest Entities" ("FIN 46") was issued in January 2003. This interpretation requires consolidation of variable interest entities ("VIE"), formerly referred to as "special purpose entities," if certain conditions are met. The interpretation applied immediately to VIE's created after January 31, 2003, and to interests obtained in VIE's after January 31, 2003. Beginning after June 15, 2003, the interpretation applied also to VIE's created or interest obtained in VIE's before January 31, 2003. In December 2003, the FASB issued FASB Interpretation No. 46R, "Consolidation of Variable Interest Entities - An Interpretation of ARB 51," (revised December 2003) ("FIN 46R"), which includes significant amendments to previously issued FIN No. 46. Among other provisions, FIN 46R includes revised transition dates for public entities. The Company adopted the provisions of FIN 46R in the first quarter of fiscal 2005. The adoption of this interpretation did not have a material effect on the Company's financial position, results of operations or cash flows.

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### 10. DISCONTINUED OPERATIONS

Discontinued operations represent closure in fiscal 2005 of two retail stores in markets in Florida and Mississippi and the closure in fiscal 2006 of one retail store in a Tennessee market where the Company does not expect another of its existing stores to absorb the closed store's customers. For the thirteen week periods ended October 29, 2005 and October 30, 2004, these stores had net sales of \$0 and \$393,000, respectively, and pretax operating losses of \$21,000 and \$41,000, respectively. For the thirty-nine week periods ended October 29, 2005 and October 30, 2004, these stores had net sales of \$109,000 and \$1,566,000, respectively, and pretax operating losses of \$68,000 and \$98,000, respectively. Also included in the loss on discontinued operations are store closing costs of \$0 and \$20,000 for the thirteen and thirty-nine weeks ended October 29, 2005, respectively. Expenses relating to store closings when the store is not classified as a discontinued operation are reported in operating, selling and administrative expenses. If the store is closed and another store is in the same market and the cash flows are expected to be materially recovered, the store is not considered a discontinued operation.

### 11. INSURANCE GAIN

In the third quarter of fiscal 2006 the Company recognized an insurance gain of \$770,000, net of taxes, related to insurance recoveries for hurricane damage suffered at three stores in the third quarter of fiscal 2005. The insurance recovery amounts were finalized with the insurance company during the third quarter of fiscal 2006, therefore the gain was recorded in the current period.

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

### SAFE HARBOR STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

This document contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 that involve a number of risks and uncertainties. A number of factors could cause our actual results, performance and achievements, or industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. These factors include, but are not limited to: a restatement of our quarterly or annual financial statements as a result of a material weakness in internal control over financial reporting; the competitive environment in the book retail industry in general and in our specific market areas; inflation; economic conditions in general and in our specific market areas; the number of store openings and closings; the profitability of certain product lines, capital expenditures and future liquidity; liability and other claims asserted against us; uncertainties related to the Internet and our internet initiatives; and other factors referenced herein. In addition, such forward-looking statements are necessarily dependent upon the assumptions, estimates and dates that may be incorrect or imprecise and involve known and unknown risks, uncertainties and other factors. Accordingly, any forward-looking statements included herein do not purport to be predictions of future events or circumstances and may not be realized. Given these uncertainties, stockholders and prospective investors are cautioned not to place undue reliance on such forward-looking statements. We disclaim any obligations to update any such factors or to publicly announce the results of any revisions to any of the forward-looking statements contained herein to reflect future events or developments.

### GENERAL



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We were founded in 1917 and as of October 29, 2005 we operate 208 retail bookstores, including 173 superstores, concentrated in the southeastern United States.

Our growth strategy is focused on opening superstores in new and existing market areas, particularly in the Southeast. In addition to opening new stores, management intends to continue its practice of reviewing the profitability trends and prospects of existing stores and closing or relocating under-performing stores or converting stores to different formats.

Comparable store sales are determined each fiscal quarter during the year based on all stores that have been open at least 12 full months as of the first day of the fiscal quarter. Any stores closed during a fiscal quarter are excluded from comparable store sales as of the first day of the quarter in which they close.

### INTERNAL CONTROL OVER FINANCIAL REPORTING

In September 2005, during the course of its effort to implement Section 404 of the Sarbanes Oxley Act, management identified certain control deficiencies. After meeting with the Audit Committee of the Board of Directors, management determined that certain of these control deficiencies constituted significant deficiencies which in the aggregate constituted a material weakness. The material weakness identified consists of a combination of the following significant deficiencies relating to accounts payable: (i) inadequate controls over the data used to perform cost of goods sold calculations; (ii) inadequate segregation of duties for accounts payable management; and (iii) inadequate independent verification of expense invoice payment supporting documentation. Please see "Controls and Procedures" herein.

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

#### RESULTS OF OPERATIONS

The following table sets forth statement of operations data expressed as a percentage of net sales for the periods presented.

	Thirteen Weeks Ended		Thirty-Nine
	October 29, 2005	October 30, 2004	October 29, 2005
Net sales	100.0%	100.0%	100.0%
Gross profit	26.1%	26.7%	27.4%
Operating, selling and administrative expenses	24.6%	23.8%	23.0%
Gain on insurance recovery	1.2%	-	0.4%
Depreciation and amortization	3.6%	4.2%	3.5%
Operating income (loss)	(0.9)%	(1.3)%	1.3%
Interest expense, net	0.4%	0.4%	0.4%
Income (loss) from continuing operations before income taxes	(1.3)%	(1.7)%	0.9%
Income taxes provision (benefit)	(0.5)%	(0.6)%	0.3%
Income (loss) from continuing operations	(0.8)%	(1.1)%	0.6%
Net income	(0.8)%	(1.1)%	0.6%

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Net sales increased \$3.5 million, or 3.4%, to \$107.6 million in the thirteen weeks ended October 29, 2005, from \$104.1 million in the thirteen weeks ended October 30, 2004. Net sales increased \$17.6 million, or 5.4%, to \$343.1 million in the thirty-nine weeks ended October 29, 2005, from \$325.5 million in the thirty-nine weeks ended October 30, 2004. Comparable store sales in the thirteen weeks ended October 29, 2005 increased 0.6% when compared with the same thirteen week period for the prior year. Comparable store sales increased 2.9% for the thirty-nine weeks ended October 29, 2005. The increase in comparable store sales for the thirteen and thirty-nine week periods was primarily due to higher sales in the book department. The book sales increase was primarily driven by the release of Harry Potter and the Half Blood Prince during the second quarter, as well as strong sales in categories such as Children's, History, Teen Fiction, Cooking, Humor and Inspirational.

The following table sets forth net sales data by segment for the thirteen weeks and the thirty-nine weeks ended October 29, 2005 and October 30, 2004:

### NET SALES BY SEGMENT (IN THOUSANDS)

	Thirteen Weeks Ended				Thirty-Nin	
	October 29, 2005	October 30, 2004	\$ Change	% Change	October 29, 2005	Octobe 200
Retail Trade	\$105,434	\$101,965	\$ 3,469	3.4%	\$ 337,656	\$ 31
Electronic Commerce						
Trade	6,807	6,571	236	3.6%	19,987	1
Intersegment Sales						
Elimination	(4,603)	(4,464)	(139)	3.1%	(14,583)	(1
Net Sales	\$107,638	\$104,072	\$ 3,566	3.4%	\$ 343,060	\$ 32

The increase in net sales for the retail trade segment was primarily due to higher comparable store sales for the thirteen and thirty-nine week periods as described above. The increase in net sales for the electronic commerce segment was primarily due to higher bestseller title order volume, including Harry Potter and the Half Blood Prince.

Gross profit increased \$0.3 million, or 1.2%, to \$28.1 million in the thirteen weeks ended October 29, 2005 when compared with \$27.8 million in the same thirteen week period for the prior year. For the thirty-nine weeks ended October 29, 2005, gross profit increased \$4.9 million, or 5.5%, to \$93.9 million from \$89.0 million in the same period last year. Gross profit as a percentage of net sales for the thirteen weeks ended October 29, 2005 was 26.1% versus 26.7% in the same period last year. Gross profit as a percentage of sales for the thirty-nine weeks ended October 29, 2005 was 27.4% versus 27.4% in the same period last year. The decrease in gross profit as a percent of net sales for the thirteen week period was due to higher occupancy costs as a percentage of net sales.

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

Operating, selling and administrative expenses were \$26.5 million in the

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thirteen week period ended October 29, 2005 compared to \$24.7 million in the same period last year. Operating, selling and administrative expenses as a percentage of net sales for the thirteen weeks ended October 29, 2005 increased to 24.6 % from 23.8% in the same period last year. For the thirty-nine weeks ended October 29, 2005, operating, selling and administrative expenses were \$78.9 million compared to \$72.4 million in the same period last year. Operating, selling and administrative expenses as a percentage of net sales for the thirty-nine weeks ended October 29, 2005 increased to 23.0% from 22.3% in the same period last year. The increase in operating, selling and administrative expenses as a percent of sales for the thirteen and thirty-nine week periods was primarily due to costs incurred for increased internal staffing and outside professional fees related to Sarbanes-Oxley Act compliance work.

Depreciation and amortization was \$3.9 million in the thirteen week period ended October 29, 2005 compared to \$4.4 million in the same period last year. In the thirty-nine week period ended October 29, 2005 depreciation and amortization decreased 10.6% to \$11.9 million from \$13.3 million in the same period last year. Decrease in depreciation and amortization expense was due to the impact of certain assets becoming fully depreciated during the prior year.

The following table sets forth operating income data by segment for the thirteen weeks and the thirty-nine weeks ended October 29, 2005 and October 30, 2004:

### OPERATING INCOME (LOSS) BY SEGMENT (IN THOUSANDS)

	Thirteen Weeks Ended				Thirty-	
	October 29, 2005	October 30, 2004	\$ Change	% Change	October 29, 2005	Octo
Retail Trade	\$(1,407)	\$(1,773)	\$ 366	20.6%	\$ 3,844	\$2
Electronic Commerce Trade	478	408	70	17.2%	650	
Intersegment Elimination of Certain Costs	(86)	48	(134)	(279.2%)	(188)	
<b>Total Operating Income (Loss)</b>	<b>\$(1,015)</b>	<b>\$(1,317)</b>	<b>\$ 302</b>	<b>22.9%</b>	<b>\$ 4,306</b>	<b>\$3</b>

The improvement in operating results for the retail trade segment for the thirteen and thirty-nine week periods was due to the gain on insurance recoveries recorded during the third quarter. Even though net sales for the electronic commerce segment for the thirty-nine weeks ended October 29, 2005 increased by 3.9%, operating income for the electronic commerce segment was slightly decreased compared with the same period last year due to strong price competition in the electronic commerce market, which put pressure on gross margins.

Interest expense was \$0.4 million in the thirteen weeks ended October 29, 2005 versus \$0.5 million in the same period last year and \$1.2 million in the thirty-nine weeks ended October 29, 2005 versus \$1.5 million in the same period last year. The decrease was primarily due to lower average debt balances compared with the prior year.

Discontinued operations represent closure in fiscal 2005 of two retail stores in markets in Florida and Mississippi and the closure in fiscal 2006 of one retail store in a Tennessee market where the Company does not expect another

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of its existing stores to absorb the closed stores' customers. For the thirteen week periods ended October 29, 2005 and October 30, 2004, these stores had net sales of \$0 and \$393,000, respectively, and pretax operating losses of \$21,000 and \$41,000, respectively. For the thirty-nine week periods ended October 29, 2005 and October 30, 2004, these stores had net sales of \$109,000 and \$1,566,000, respectively, and pretax operating losses of \$68,000 and \$98,000, respectively. Also included in the loss on discontinued operations are store closing costs of \$0 and \$20,000 for the thirteen and thirty-nine weeks ended October 29, 2005, respectively. Expenses relating to store closings when the store is not classified as a discontinued operation are reported in operating, selling and administrative expenses. If the store is closed and another store is in the same market and the cash flows are expected to be materially recovered, the store is not considered a discontinued operation.

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

#### LIQUIDITY AND CAPITAL RESOURCES

The Company's primary sources of liquidity are cash flows from operations, including credit terms from vendors, and borrowings under its credit facility. The Company has an unsecured revolving credit facility that allows borrowings up to \$100 million, for which no principal repayments are due until the facility expires in July 2007. The credit facility has certain financial and non-financial covenants, the most restrictive of which is the maintenance of a minimum fixed charge coverage ratio. The Company is in compliance with all of the covenants, including the minimum fixed charge coverage ratio, as of October 29, 2005. As of October 29, 2005 and January 29, 2005, \$7.2 million and \$0, respectively, were outstanding under this credit facility. The maximum and average outstanding balances during the thirteen weeks ended October 29, 2005 were \$18.5 million and \$11.2 million, respectively, compared to \$30.2 million and \$21.4 million, respectively, for the same period in the prior year. The maximum and average outstanding balances during the thirty-nine weeks ended October 29, 2005 were \$23.7 million and \$11.7 million, respectively, compared to \$34.4 million and \$24.0 million, respectively, for the same period in the prior year. The decrease in the maximum and average outstanding balances from the prior year was due to the pay down of debt during fiscal 2005 with cash provided by operating activities. The outstanding borrowings as of October 29, 2005 had interest rates ranging from 3.89% to 5.53%.

In addition, as of October 29, 2005 and January 29, 2005, the Company had outstanding borrowings under the Bond, an industrial revenue bond, totaling \$7.5 million which is secured by certain property. The Bond has a maturity date of December 1, 2019, with a purchase provision obligating the Company to repurchase the Bond on May 30, 2007, unless extended by the bondholder. Such an extension may be renewed annually by the bondholder, at the Company's request, to a date not more than five years from the renewal date.

#### Financial Position

Inventory balances at October 29, 2005 compared to January 29, 2005 increased due to increased purchases in preparation for the holiday season. Accrued expenses at October 29, 2005 compared to January 29, 2005 decreased due to larger capital expenditure accruals at year-end due to significant purchases of capital assets in the fourth quarter of fiscal 2005, and payment of fiscal 2005 management bonuses in the first quarter of fiscal 2006. Annual bonuses are normally paid in the first quarter of the year following the year the bonus was earned.

#### CONTRACTUAL OBLIGATIONS

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The following table lists the aggregate maturities of various classes of obligations and expiration amounts of various classes of commitments related to Books-A-Million, Inc. at October 29, 2005 (in thousands):

### PAYMENTS DUE UNDER CONTRACTUAL OBLIGATIONS

	Total	FY 2006	FY 2007	FY 2008	FY 2009
	-----	-----	-----	-----	-----
Long-term debt-revolving credit facility (1)	\$ 7,240	-	-	7,240	-
Long-term debt -industrial revenue bond (2)	7,500	-	-	7,500	-
Subtotal of debt	14,740	-	-	14,740	-
Operating leases	139,653	7,829	29,720	26,351	21,110
Total of obligations	\$ 154,393	\$ 7,829	\$ 29,720	\$ 41,091	\$ 21,110

(1) Revolving credit facility expires in July 2007.

(2) The Bond has a maturity date of December 1, 2019, with a purchase provision obligating the Company to repurchase the Bond on May 30, 2007, unless extended by the bondholder. Such an extension may be renewed annually by the bondholder, at the Company's request, to a date not more than five years from the renewal date.

### GUARANTEES

From time to time, the Company enters into certain types of agreements that contingently require the Company to indemnify parties against third party claims. Generally these agreements relate to: (a) agreements with vendors and suppliers, under which the Company may provide customary indemnification to its vendors and suppliers in respect of actions they take at the Company's request or otherwise on its behalf; (b) agreements to indemnify the vendors against trademark and copyright infringement claims concerning the books published or merchandise manufactured specifically for or on behalf of the Company; (c) real estate leases, under which the

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

Company may agree to indemnify the lessors from claims arising from the Company's use of the property; and (d) agreements with the Company's directors, officers and employees, under which the Company may agree to indemnify such persons for liabilities arising out of their relationship with the Company. The Company has Directors and Officers Liability Insurance, which, subject to the policy's conditions, provides coverage for indemnification amounts payable by the Company with respect to its directors and officers up to specified limits and subject to certain deductibles.

The nature and terms of these types of indemnities vary. The events or

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circumstances that would require the Company to perform under these indemnities are transaction and circumstance specific. Generally, the Company's maximum liability under such indemnities is not explicitly stated, and therefore the overall maximum amount of the Company's obligations cannot be reasonably estimated. Historically, the Company has not incurred significant costs related to performance under these types of indemnities. No liabilities have been recorded for these obligations on the Company's balance sheet at October 29, 2005 and January 29, 2005 as such liabilities are considered de minimis.

### Cash Flows

Operating activities provided (used) cash of (\$6.8) million and \$4.4 million in the thirty-nine week periods ended October 29, 2005 and October 30, 2004, respectively, and included the following effects:

- Cash used for inventories in the thirty-nine week periods ended October 29, 2005 and October 30, 2004 was \$16.6 million and \$16.9 million, respectively.
- Cash provided by accounts payable in the thirty-nine week periods ended October 29, 2005 and October 30, 2004 was \$2.8 million and \$12.8 million, respectively. This change was due to the timing of payments for purchases from vendors in the first nine months of fiscal 2006.
- Depreciation and amortization expenses were \$11.9 million and \$13.4 million, respectively in the thirty-nine week periods ended October 29, 2005 and October 30, 2004. Decrease in depreciation and amortization expense was due to the impact of certain assets becoming fully depreciated during the prior year.

Cash flows used in investing activities reflected a \$9.5 million and \$7.0 million net use of cash for the thirty-nine week periods ended October 29, 2005 and October 30, 2004, respectively. Cash was used primarily to fund capital expenditures for new stores, store relocations, renovation and improvements to existing stores and investments in management information systems.

Financing activities provided cash of \$4.8 million and \$1.9 million in the thirty-nine week periods ended October 29, 2005 and October 30, 2004, respectively, principally from borrowings under the revolving credit facility.

On June 23, 2005, the Company commenced a modified "Dutch Auction" tender offer (the "Tender Offer") to purchase up to 4,000,000 shares of its outstanding common stock at a price per share of not less than \$8.75 nor in excess of \$10.00 per share, for an aggregate purchase price of up to \$40.0 million. Pursuant to the Tender Offer, the Company purchased 56,406 shares of common stock at a purchase price of \$10.00 per share, for a total cost of \$564,060.

### OUTLOOK

During the thirty-nine weeks ended October 29, 2005, the Company opened five stores, relocated three stores, remodeled fifteen stores and closed three stores. For the remainder of fiscal 2006, the Company expects to open two stores, complete remodels on approximately five stores and close three stores. The Company's capital expenditures totaled \$9.5 million in the thirty-nine week period ended October 29, 2005. Management estimates that capital expenditures for the remainder of fiscal 2006 will be approximately \$3.8 million and that such amounts will be used primarily for opening new stores and remodeling existing stores, upgrading and expanding warehouse distribution facilities and investing in management information systems. Management believes that existing cash on hand and net cash from operating activities, together with borrowings under the Company's credit facilities, will be adequate to finance the Company's planned capital expenditures and to meet the Company's working capital

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requirements for the remainder of fiscal 2006 and for all of fiscal 2007.

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

#### RELATED PARTY ACTIVITIES

Charles C. Anderson, a former director of the Company, Terry C. Anderson, a director of the Company, and Clyde B. Anderson, a director and officer of the Company, have controlling ownership interests in other entities with which the Company conducts business. Significant transactions between the Company and these various other entities ("related parties") are summarized in the following paragraphs.

The Company purchases a substantial portion of its magazines as well as certain of their seasonal music and newspapers from Anderson Media Corporation ("Anderson Media"), an affiliate through common ownership. During the thirteen and thirty-nine weeks ended October 29, 2005 purchases of these items from Anderson Media totaled \$12,485,000 and \$25,425,000, respectively, compared to \$8,708,000 and \$24,645,000 during the same periods last year. The Company purchases certain of its collectibles and books from Anderson Press, Inc. ("Anderson Press"), an affiliate through common ownership. During the thirteen and thirty-nine weeks ended October 29, 2005, such purchases from Anderson Press totaled \$505,000 and \$1,162,000, respectively, compared to \$355,000 and \$580,000 during the same periods last year. The Company purchases certain of its greeting cards and gift products from C.R. Gibson, Inc. ("C.R. Gibson"), an affiliate through common ownership. The purchases of these products from C.R. Gibson during the thirteen and thirty-nine weeks ended October 29, 2005 were \$22,000 and \$156,000, respectively, compared to \$48,000 and \$278,000 during the same periods last year. The Company purchases certain magazine subscriptions from Magazines.com, an affiliate through common ownership. During the thirteen and thirty-nine weeks ended October 29, 2005, purchases of these items from Magazines.com were \$17,000 and \$44,000, respectively, compared to \$16,000 and \$53,000 in the same periods last year. The Company purchases content for publication from Publication Marketing Corporation ("Publication Marketing"), an affiliate through common ownership. During the thirteen and thirty-nine weeks ended October 29, purchases of these items from Publication Marketing were \$24,000 and \$53,000, respectively, compared to \$27,000 and \$51,000 during the same periods last year. The Company utilizes import sourcing and consolidation services from Anco Far East Importers, LTD ("Anco Far East"), an affiliate through common ownership. The total paid to Anco Far East was \$370,000 and \$1,768,000 during the thirteen and thirty-nine weeks ended October 29, 2005, respectively, compared to \$583,000 and \$905,000 during the same periods last year. These amounts paid to Anco Far East primarily included the actual cost of the product as well as fees for sourcing and consolidation services. All costs other than the sourcing and consolidation service fees were passed through from other vendors. Anco Far East fees, net of the passed-through costs, were \$26,000 and \$124,000 during the thirteen and thirty-nine weeks ended October 29, 2005, respectively, compared to \$41,000 and \$63,000 during the same periods last year.

The Company sold books to (received returns from) Anderson Media in the amounts of \$233,000 and \$239,000 during the thirteen and thirty-nine weeks ended October 29, 2005, respectively, compared to (\$47,000) and (\$78,000) during the same periods last year. During the thirteen and thirty-nine weeks ended October 29, 2005, the Company provided \$0 and \$7,000, respectively, of internet services to Magazines.com, compared to \$206,000 and \$253,000 during the same periods last year. The Company provided internet services to American Promotional Events, an affiliate through common ownership, of \$6,000 and \$69,000 during the thirteen and thirty-nine weeks ended October 29, 2005, respectively, compared to \$8,000 and \$62,000 during the same periods last year.

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The Company leases its principal executive offices from a trust, beneficiaries of which are the grandchildren of Mr. Charles C. Anderson, a former member of the Board of Directors. The lease extends to January 31, 2006. During the thirteen and thirty-nine weeks ended October 29, 2005, the Company paid rent of \$34,000 and \$103,000, respectively, to the trust under this lease compared to \$34,000 and \$103,000 during the same periods last year. Anderson & Anderson LLC ("A&A"), an affiliate through common ownership, also leases three buildings to the Company. During the thirteen and thirty-nine weeks ended October 29, 2005, the Company paid A&A a total of \$111,000 and \$333,000, respectively, in connection with such leases compared to \$110,000 and \$331,000 during the same periods last year. Total minimum future rental payments under all of these leases are \$34,000 at October 29, 2005. The Company subleases certain property to Hibbett Sporting Goods, Inc. ("Hibbett"), a sporting goods retailer in the southeastern United States. The Company's Executive Chairman, Clyde B. Anderson, is a member of Hibbett's board of directors. During the thirteen and thirty-nine weeks ended October 29, 2005, the Company received \$62,000 and \$157,000, respectively, in rent payments from Hibbett compared to \$48,000 and \$143,000 during the same periods last year.

The Company shares ownership of a plane, which the Company uses in the operation of its business, with an affiliated company. The Company rents the plane to affiliated companies at rates that cover all of the variable cost and a portion of the fixed cost of the plane. The total amounts received from affiliated companies for use of the plane during the thirteen and thirty-nine weeks ended October 29, 2005 were \$82,000 and \$238,000, respectively, compared to \$13,000 and \$144,000 during the same periods last year. The Company also occasionally rents a plane from A&A as well. The amounts paid to A&A for plane rental were \$4,000 and \$35,000 for the thirteen and thirty-nine weeks ended October 29, 2005, respectively compared to \$6,000 and \$22,000 during the same periods last year.

### QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is subject to interest rate fluctuations involving its credit facilities and debt related to an industrial development revenue bond (the "Bond"). However, the Company uses fixed interest rate hedges to manage a portion of this exposure. The Company entered into two separate \$10 million interest rate swaps on July 24, 2002 (the "Credit Facility Hedges"), which effectively fixed the interest rate on \$20 million of variable credit facility debt at 5.13%. Both of the Credit Facility Hedges expired in August 2005, and the Company has not replaced the Credit Facility Hedges. In addition, the Company entered into a \$7.5 million interest rate swap in May 1996 that expires in June 2006 and effectively fixes the interest rate on the Bond at 8.73% (the "Bond Hedge"). The counterparty to the Bond Hedge is a primary bank in the Company's credit facility. The Company believes the credit and liquidity risk of the counter party failing to meet its obligation under the Bond Hedge is remote.

To illustrate the sensitivity of the results of operations to changes in interest rates on its debt, the Company estimates that a 66% increase in LIBOR rates would have increased interest expense by approximately \$74,000 for the thirteen weeks ended October 29, 2005. Likewise, a 66% decrease in LIBOR rates would have decreased interest expense by \$74,000 for the thirteen weeks ended October 29, 2005. This hypothetical change in LIBOR rates was calculated based on the fluctuation in LIBOR in 2002, which was the maximum LIBOR fluctuation in the last ten years. The estimates do not consider the effect of the potential termination of the Bond Hedge associated with the Bond would have on interest expense.



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### CONTROLS AND PROCEDURES

We are committed to maintaining disclosure controls and procedures designed to ensure that information required to be disclosed in our reports under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), is recorded, processed, summarized and reported within the time periods specified in the Commission's rules and forms, and that such information is accumulated and communicated to our management, including our chief executive officer, chief financial officer and the Board of Directors, as appropriate, to allow for timely decisions regarding required disclosure. As required by Rules 13a-15 and 15d-15 under the Exchange Act, management, with the participation of our chief executive officer and chief financial officer, has evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. In designing and evaluating disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures and implementing controls and procedures based on the application of management's judgment.

In September 2005, during the course of its effort to implement Section 404 of the Sarbanes Oxley Act, management identified certain control deficiencies. After meeting with the Audit Committee of the Board of Directors, management determined that certain of these control deficiencies constituted significant deficiencies which in the aggregate constituted a material weakness. The Public Company Accounting Oversight Board's Auditing Standard No. 2 defines a significant deficiency as a control deficiency, or combination of control deficiencies, that adversely affects the company's ability to initiate, authorize, record, process, or report external financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the company's annual or interim financial statements that is more than inconsequential will not be prevented or detected and defines a material weakness as a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. As a result of this material weakness, our chief executive officer and chief financial officer concluded that, as of the end of the fiscal quarter covered by this report, our disclosure controls and procedures were not effective at the reasonable assurance level.

The material weakness identified consists of a combination of the following significant deficiencies relating to accounts payable: (i) inadequate controls over the data used to perform cost of goods sold calculations; (ii) inadequate segregation of duties for accounts payable management; and (iii) inadequate independent verification of expense invoice payment supporting documentation.

Inadequate controls over the data used to perform cost of goods sold calculations. Because we do not accumulate product cost data at the item level, we calculate cost of goods sold and determine vendor payments and return credits using product line cost data for each vendor. We generally purchase inventory at a wholesale cost that is expressed as a discount from the suggested retail price for the product. When merchandise is received at the warehouse, the discount percentage established for each vendor is used to calculate the expected cost of the merchandise and a warehouse receipt is generated. The warehouse receipt is matched to the vendor's invoice at the total receipt/invoice level to ensure the accuracy of the receipt of product ordered and the amount of payment due to the vendor.

Many vendors have several different product lines which may have different

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discount percentages. For example, publishers, who collectively constitute a majority of our vendors, have several different imprints under which they publish and sell books which they sell to us under varying discount percentages. However, information used in the item master file, which is within the warehouse system, to calculate cost of receipts and returns is generated based on a standard discount percentage at the vendor level, which may not match the discount percentage on each product line that we purchase from or return to that vendor. Calculations done at the vendor discount level can cause discrepancies in the cost amounts determined for the merchandise receipts and returns versus the amounts charged by the vendor. Discrepancies in merchandise receipt amounts versus vendor invoice amounts above certain tolerances are reviewed to ensure the vendor is paid the proper amount. However, the cumulative effect of discrepancies under the tolerance levels could have an impact on inventory shrinkage. The cost charged for product on returns is based on the vendor discount reflected in the system and is not reconciled until after the vendor issues credit for the return. A delay in vendor processing of returns, which could increase unresolved return disputes, could also impact inventory shrinkage results.

In addition, because of the lack of item level cost detail for products, a weighted average cost by product line must be determined, which is then applied to sales amounts to calculate cost of goods sold. The weighted average cost percentages are calculated using invoice level data to determine the cost of goods sold percentages by product line. The percentages are determined for each product line using a sampling of invoices for each period. We have determined that the sample size used historically may have not been large enough to allow us to adequately calculate cost of goods sold on a quarterly basis.

### CONTROLS AND PROCEDURES

Due to the risk that discrepancies could arise which could affect our vendor payment and return cost calculations which could, in turn, impact our cost of goods sold, we have updated item level cost data in the item master file and will continue to maintain item level cost data on the item master file going forward. This will provide accurate item level cost information for merchandise purchase orders and publisher returns processed going forward. Due to the completion of the update to, and the ongoing maintenance of item level cost data, we expect to begin using item level detail in the cost of goods sold calculation by April 29, 2006, the end of the first quarter of fiscal 2007.

To mitigate the risk of error until we begin using item level cost data in the cost of goods sold calculations, during the second and third quarters of fiscal 2006 we performed a reconciliation of inventory balances per the financial records to the physical inventory per the perpetual inventory system for the warehouse. This reconciliation process involved a detailed review of activity posted to the financial records since the last physical inventory at the warehouse in the fourth quarter of fiscal 2005 and compares the financial inventory balances to the physical totals per the perpetual inventory system. The shrinkage calculated during the reconciliation completed for the second and third quarters of fiscal 2006 was not material. A full physical inventory at the warehouse will be taken and reconciled to the financial records during the fourth quarter of fiscal 2006. Also, the sample size of invoices reviewed for verifying the cost of goods sold percentages by product line was expanded in the third quarter, and will be further expanded during the fourth quarter of fiscal 2006, until the new system for calculating the cost of goods sold at the item level discount is in place.

The additions to and maintenance of item level discount percentages on the item master file is also expected to improve the accuracy of discount percentages used to calculate the credits for merchandise returns. This is

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expected to reduce the risk of miscalculating the credits for returns significantly. We will continue to reconcile the major vendors' statement activity to payables activity on a quarterly basis to identify return differences and resolve those discrepancies with vendors.

Inadequate segregation of duties for accounts payable management and inadequate controls over access to the payables vendor master file. The director of accounts payable and the manager of accounts payable together manage all accounts payable, including the reconciliation of accounts payable detail activity to the general ledger. While our procedures for accounts payable stated that neither the director nor the manager were allowed to be involved in vendor master file maintenance, as of the end of the second quarter the system did not prevent either of them from making entries to, or performing maintenance on, the vendor master file. As of October 14, 2005, access privileges to the vendor file for the director and the manager have been revoked. Also, starting with the October, 2005 monthly closing process, a senior accounting manager outside of the accounts payable function is reviewing the reconciliation of the accounts payable detail activity to the general ledger each month. Management believes that this significant deficiency has been remediated as of the end of the third quarter of fiscal 2006.

Inadequate independent verification of expense invoice supporting documentation. In addition to having responsibility for the merchandise payment process, the accounts payable department also has the responsibility to manage and process payments for expense invoices. Our policies and procedures in place as of the second quarter of fiscal 2006 were not adequate to ensure that expense invoices processed for payment were approved by management at the appropriate level and that supporting documentation was adequate to support the amount being paid.

We have established company wide expense approval policies and procedures by department that specifically identify which employees have authority for approving invoices, the maximum dollar threshold they can approve and the dollar threshold at which additional approval is required. These new policies and procedures were implemented on October 14, 2005. As of the date for filing this quarterly report on Form 10-Q, new policies and procedures were also implemented requiring supporting documentation to be provided with expense invoices for certain categories of expense activity for approval by management.

To mitigate the risk of misstatement of expense activity during the second and third quarters of fiscal 2006, we completed a subsequent review of invoices processed for sixty days after the end of the second quarter and for thirty days after the end of the third quarter. This process did not identify any significant changes to the amounts originally accrued for the each of the quarter closings.

### CONTROLS AND PROCEDURES

Although we continue to implement remediation efforts, a material weakness indicates that there is more than a remote likelihood that a material misstatement of our financial statements will not be prevented or detected in a future period. In addition, we cannot assure you that we will not in the future identify additional material weaknesses or significant deficiencies in our internal control over financial reporting. The efforts we have taken and continue to take are subject to continued management review supported by confirmation and testing by management, our internal auditors and the outside consultants, as well as audit committee oversight. As a result, additional changes are expected to be made to our internal control over financial reporting. There have been no other material changes during the current quarter in our disclosure controls and procedures, or our internal control over

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financial reporting that have materially affected, or are reasonably likely to materially affect, our disclosure controls and procedures or our internal control over financial reporting.

### II - OTHER INFORMATION

#### ITEM 1: Legal Proceedings

The Company is a party to various legal proceedings incidental to its business. In the opinion of management, after consultation with legal counsel, the ultimate liability, if any, with respect to those proceedings is not presently expected to materially affect the financial position, results of operations or cash flows of the Company.

#### ITEM 1A: Risk Factors

We operate on a 52-53 week fiscal year ending on the Saturday closest to January 31st and fiscal quarters ending on the last Saturday of April, July and October. As a result, our past practice has been to file our Annual Report on Form 10-K in April and our Quarterly Reports on Form 10-Q in June, September and December, respectively. Consistent with our past practice, therefore, we are filing this Form 10-Q after December 1. Although this Item 1A requires us to disclose material changes from risk factors previously disclosed in our Form 10-K, we are unable to do so because we have not previously included risk factors in our Form 10-K. We will include risk factors in our Form 10-K for fiscal 2006 (which we anticipate will be filed in April 2006), and in all Forms 10-Q filed thereafter we will include, in accordance with this item, all material changes from risk factors previously disclosed in our Forms 10-K.

#### ITEM 2: Unregistered Sales of Equity Securities and Use of Proceeds

##### Issuer Purchases of Securities

In March 2004, the Board of Directors authorized a new common stock repurchase program for up to 10% of the outstanding stock, or 1,646,624 shares. The following table shows common stock repurchases under the program during fiscal 2006:

Period -----	Total Number of Shares Purchased -----	Average Price Paid per Share -----	Total Number of Shares Purchased as Part of Publicly Announced Program -----	Ma of S Yet Und at ---
1/30/2005 to 2/26/2005	74,001	\$ 9.4833	74,001	
2/27/2005 to 3/2/2005	17,040	\$ 9.0282	17,040	
3/3/2005 to 3/30/2005	52,530	\$ 9.4552	52,530	
8/26/2005	97,000	\$10.0000	97,000	
	-----	-----	-----	
Total	240,571	\$9.6533	240,571	
	-----	-----	-----	

Clyde B. Anderson and Charles C. Anderson, Jr. purchased a total of 97,000 shares from Sandra B. Cochran during the third quarter of fiscal 2006 under the Company's stock repurchase program previously announced in March 2004.

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### ITEM 3: Defaults Upon Senior Securities

None

## II - OTHER INFORMATION

### ITEM 4: Submission of Matters to a Vote of Security Holders

None

### ITEM 5: Other Information

None

### ITEM 6: Exhibits and Reports on Form 8-K

#### (A) Exhibits

Exhibit 3i Certificate of Incorporation of Books-A-Million, Inc. (incorporated herein by reference to Exhibit 3.1 in the Company's Registration Statement on Form S-1 (Capital Registration No. 33-52256))

Exhibit 3ii By-Laws of Books-A-Million, Inc. (incorporated herein by reference to Exhibit 3.2 in the Company's Registration Statement on Form S-1 (Capital Registration No. 33-52256))

Exhibit 31.1 Certification of Clyde B. Anderson, Executive Chairman of the Board of Books-A-Million, Inc., pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, filed under Exhibit 31 of Item 601 of Regulation S-K.

Exhibit 31.2 Certification of Sandra B. Cochran, President and Chief Executive Officer of Books-A-Million, Inc., pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, filed under Exhibit 31 of Item 601 of Regulation S-K.

Exhibit 31.3 Certification of Richard S. Wallington, Chief Financial Officer of Books-A-Million, Inc., pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, filed under Exhibit 31 of Item 601 of Regulation S-K.

Exhibit 32.1 Certification of Clyde B. Anderson, Executive Chairman of the Board of Books-A-Million, Inc., pursuant to 18 U.S.C. Section 1350, filed under Exhibit 32 of Item 601 of Regulation S-K.

Exhibit 32.2 Certification of Sandra B. Cochran, President and Chief Executive Officer of Books-A-Million, Inc., pursuant to 18 U.S.C. Section 1350, filed under Exhibit 32 of Item 601 of Regulation S-K.

Exhibit 32.3 Certification of Richard S. Wallington, Chief Financial Officer of Books-A-Million, Inc., pursuant to 18 U.S.C. Section 1350, filed under Exhibit 32 of Item 601 of Regulation S-K.

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the

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undersigned duly authorized.

BOOKS-A-MILLION, INC.

Date: December 13, 2005

by: /s/ Clyde B. Anderson  
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Clyde B. Anderson  
Executive Chairman of the Board

Date: December 13, 2005

by: /s/ Sandra B. Cochran  
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Sandra B. Cochran  
President and Chief Executive Officer

Date: December 13, 2005

by: /s/ Richard S. Wallington  
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Richard S. Wallington  
Chief Financial Officer