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Jefferson Research & Management

Torpedo Alert Short Profile Update

Circuit City Group (CC)

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Conference Call Notes: CC

Circuit City reported results for its third quarter ended November 30, 2002. Sales were $2.42 billion, up 7% from $2.26 billion a year ago. Comparable store sales were up 6% versus last year (using a nonstandard definition of comps discussed below). The company reported a loss from operations of $0.10. Although this beat First Call consensus estimates of $0.13, remember that Circuit City lowered third quarter guidance a month ago from "a slight profit" to a loss of 5-8 cents. It should be noted that the company did not spend as much as expected on remodeling which also helped the results. Financing income was down over 50 percent due to increased repayment problems in part.

The company's conference call was arguably downbeat, with management providing very little additional insight into the current state of the company's operations beyond the obvious sluggish economy. The company offered no guidance on next year and most of the answers about competition were answered with: " we respond to the competition and aim to be competitive."

Furthermore, the company repeatedly failed to answer analyst questions about its cash balance, which declined significantly. Cash declined from $846 to $437 million (around $2 per share) over the quarter dropping $409 million in the quarter while it declined about $130 million in the same quarter a year ago. Management was asked four times how much of the cash balance on the balance sheet was committed to the receivables securitization program and never answered the question, instead referring questioners to the 10Q filed on October 15th. We have not found the number yet (but will continue looking for it and advise clients) but we are assuming that it significantly reduces the amount of cash the company has to operate with.

In conclusion, we believe Circuit City is in trouble and the problems we identified are now coming home to roost. The company is disappointing after lowering guidance. Gross margins are falling, with management admitting to competitive pressure, and CarMax results are unable to prop up the declining electronics stores. Furthermore, business is unlikely to improve given the sluggish holiday season and increasing competition from discount shops like Wal-Mart. Meanwhile, Wall Street analysts appear to be losing confidence in Circuit City's management, and in some cases the relationship appears to be turning adversarial based on some of the questions that were asked. Downgrades would not surprise us- particularly given the breakdown in finance income.

Below are our Things to look for with our **comments in bold**:

1. Declining gross margins in light of increasing competition and increased promotional activities.

   Gross Margins in the quarter fell to 22.6% from 24.4% a year ago. Operating Margin fell to -1.4% from 0.7% last year. Management specifically cited heavy promotions and sales as the primary reason for declining margins.

2. Any indicators that the banking revenues from CarMax go away with the separation of CarMax from Circuit City Group.

   Circuit City is still reporting finance income ($8.3 million in the third quarter), although substantially less that last year ($17.8 million). This decline is partly due to the elimination of appliances last year but also due to increasing delinquencies

3. Lower guidance in comp sales growth going forward as the comparison numbers get tougher.

   Comparable store sales were up 6% compared to Best Buy's sales up 2.2%. Remember, however, that Circuit City's same store sales are effectively going against very weak comparables since it discontinued the appliance business and does not count appliance revenues in prior year sales. For the fourth quarter, Best Buy is projecting a "slight increase" in same-store sales, but Circuit City provided no guidance.

Key Indicators

Summary of problems	Indicators	Latest Indicator Fundamental Strength	Next Info	Comment
1. Increasing competition with Best Buy in the company's core electronics business.	Gross Margins Sales per Store (ttm) Head to Head Market Share.	**Worse**	Q4 earnings release.	**Gross Margins continued to decline. 3rd quarter gross margins were down to 22.6% from 24.4% last year.**
2. Bad debt write-offs are increasing, while the company's allowance for doubtful accounts has fallen.	Allowance for doubtful receivables Bad debt write-offs	**Worse**	10K Late April, 2003	**No new information on write-off expenses, but increased write-offs for financings were mentioned as one cause of decline in finance earnings.**
3. Reliance on CarMax for a large portion of earnings.	CarMax % of total earnings.	Unchanged	N/A	**CarMax results are now listed as "discontinued operations" on Circuit City's financial statements. As a result, problems at flagship electronics stores are now more transparent.**
4. Reliance on the banking division for a large part of operating earnings.	Financing earnings as % of pre-tax earnings	**Worse**	Q4 Earnings release.	**Finance Earnings were down 53% in the third quarter compared to last year.**
5. Current strong same store sales growth due to weak comparables from the previous year.	Same store sales	**Mixed**	Q4 Earnings release.	**Comp Store sales were up 6% in the third quarter. No guidance was given, but the company faces tougher comparables in the fourth quarter.**

Upcoming Events

(Note: Risk Level is risk to shareholders of the stock.)

Date	Risk Level	Event
January 9, 2003	High	BBY reports December sales figures
January 9 - 12, 2003	Low	Consumer Electronics Show (Las Vegas, Nevada)
March 6, 2003	High High	CC reports fourth quarter and fiscal year 2003 sales. Comparables become tougher to beat this quarter. BBY reports third quarter and fiscal year 2003 sales
Late March or Early April, 2003	Medium Low	CC reports fourth quarter and fiscal year 2003 earnings BBY reports third quarter and fiscal year 2003 earnings