

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

FOR ANNUAL AND TRANSITION REPORTS
PURSUANT TO SECTIONS 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

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

For the fiscal year ended February 1, 2003

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

For the transition period from _____ to _____

Commission File No. 1-12302

Barnes & Noble, Inc.

(Exact name of registrant as specified in its Charter)

Delaware	06-1196501
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
122 Fifth Avenue, New York, NY	10011
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (212) 633-3300

Securities registered pursuant to Section 12(b) of the Act:
Common Stock, \$0.001 par value per share

New York Stock Exchange

(Title of Class)

(Name of Exchange on
which registered)

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

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K 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 an accelerated filer (as defined in Rule 12b-2 of the Act). Yes No

The aggregate market value of the voting and non-voting stock held by non-affiliates of the registrant was approximately \$1,085,113,218 based upon the closing market price of \$20.05 per share of Common Stock on the New York Stock Exchange as of August 2, 2002.

Number of shares of \$.001 par value Common Stock outstanding as of March 31, 2003: 64,950,538

[Table of Contents](#)

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's Proxy Statement for the 2003 Annual Meeting of Shareholders are incorporated by reference into Part III.

Portions of the Registrant's Annual Report to Shareholders for the fiscal year ended February 1, 2003 are incorporated by reference into Parts II and IV.

TABLE OF CONTENTS

PART I

ITEM 1. BUSINESS

ITEM 2. PROPERTIES

ITEM 3. LEGAL PROCEEDINGS

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

ITEM 6. SELECTED FINANCIAL DATA

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

ITEM 11. EXECUTIVE COMPENSATION

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

ITEM 14. CONTROLS AND PROCEDURES

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

SIGNATURES

CERTIFICATION OF CHIEF EXECUTIVE OFFICER

CERTIFICATION OF CHIEF FINANCIAL OFFICER

EX-10.5: EMPLOYMENT AGREEMENT WITH STEPHEN RIGGIO

EX-13.1: SELECTED CONSOLIDATED FINANCIAL DATA

EX-21.1: LIST OF SUBSIDIARIES

EX-23.1: CONSENT OF BDO SEIDMAN, LLP

EX-23.2: REPORT OF BDO SEIDMAN, LLP

EX-99.1: CERTIFICATION OF CEO

EX-99.2: CERTIFICATION OF CFO

TABLE OF CONTENTS

			Page
PART I			
Item	1.	Business	4
Item	2.	Properties	16
Item	3.	Legal Proceedings	17
Item	4.	Submission of Matters to a Vote of Security Holders	18
PART II			
Item	5.	Market for Registrant's Common Equity and Related Stockholder Matters	18
Item	6.	Selected Financial Data	19
Item	7.	Management's Discussion and Analysis of Financial Condition and Results of Operations	19
Item	7a.	Quantitative and Qualitative Disclosures About Market Risk	19
Item	8.	Financial Statements and Supplementary Data	19
Item	9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	20
PART III			
Item	10.	Directors and Executive Officers of the Registrant	20
Item	11.	Executive Compensation	20
Item	12.	Security Ownership of Certain Beneficial Owners and Management	20
Item	13.	Certain Relationships and Related Transactions	21
Item	14.	Controls and Procedures	21
PART IV			
Item	15.	Exhibits, Financial Statement Schedules and Reports on Form 8-K	22
		Signatures	28
		Certification of Chief Executive Officer	29
		Certification of Chief Financial Officer	31

PART I

ITEM 1. BUSINESS

General

Barnes & Noble, Inc. (Barnes & Noble or the Company), the nation's largest bookseller*, as of February 1, 2003 operated 886 bookstores and 1,231 video-game and entertainment-software stores. Of the 886 bookstores, 628 operate under the Barnes & Noble Booksellers, Bookstop and Bookstar trade names (47 of which were opened in the year ended February 1, 2003) and 258 operate under the B. Dalton Bookseller, Doubleday Book Shops and Scribner's Bookstore trade names. Through its approximate 38 percent interest in barnesandnoble.com llc (Barnes & Noble.com), the Company is one of the largest sellers of books on the Internet. The Company, through its approximate 63 percent interest in GameStop Corp., is the nation's largest video-game and PC-entertainment software specialty retailer, operating 1,231 video-game and entertainment-software stores as of February 1, 2003 under the GameStop, Babbage's, Software Etc. and FuncoLand trade names, a Web site, gamestop.com, and *Game Informer*, one of the largest multi-platform video-game magazines, with circulation of over one million subscribers (collectively, GameStop or Video Game & Entertainment Software).

The Company's principal business is the retail sale of trade books (generally hardcover and paperback consumer titles, excluding educational textbooks and specialized religious titles), mass market paperbacks (such as mystery, romance, science fiction and other popular fiction), children's books, bargain books, magazines and music. These collectively account for substantially all of the Company's bookstore sales. During fiscal 2002, the Company's share of the consumer book market was approximately 16 percent. Bestsellers represent only three percent of Barnes & Noble store sales.

The Company's fiscal year is comprised of 52 or 53 weeks, ending on the Saturday closest to the last day of January. The fiscal years ended February 1, 2003 (fiscal 2002) and February 2, 2002 (fiscal 2001) were comprised of 52 weeks.

The Company's sales increased \$398.9 million or 8.2% during fiscal 2002 to \$5.269 billion from \$4.870 billion during fiscal 2001. Contributing to this improvement was an increase of \$231.4 million from GameStop store sales.

Barnes & Noble Bookstores

General

Barnes & Noble is the nation's largest operator of bookstores* with 628 Barnes & Noble bookstores located in 49 states and the District of Columbia as of February 1, 2003. With more than 35 years of bookselling experience, management has a strong sense of customers' changing needs. The Company leads book retailing with a "community store" concept. Barnes & Noble's typical bookstore offers a comprehensive title base, a café, a children's section, a music department, a magazine section and a calendar of ongoing events, including author appearances and children's activities, that make each Barnes & Noble bookstore an active part of its community.

* Based upon sales reported in trade publications and public filings.

[Table of Contents](#)

Barnes & Noble bookstores range in size from 10,000 to 60,000 square feet depending upon market size. Barnes & Noble bookstores opened during fiscal 2002 added 1.0 million square feet to the Barnes & Noble bookstore base, bringing the total square footage to 15.2 million square feet, a seven percent increase over the prior fiscal year. Fiscal 2002 sales from Barnes & Noble bookstores, which contributed 91.3 percent of the Company's total bookstore sales, increased 6.4% to \$3.575 billion from \$3.359 billion in fiscal 2001. The Company plans to open between 35 and 40 Barnes & Noble bookstores in the fiscal year ending January 31, 2004 (fiscal 2003), which are expected to average 25,000 square feet in size. The Company believes that the key elements contributing to the success of the Barnes & Noble bookstores are:

Proximity to Customers. The Company's strategy is to increase its share of the consumer book market, as well as to increase the size of the market. Since it began its bookstore roll-out, the Company has employed a market clustering strategy. As of February 1, 2003, Barnes & Noble had stores in 156 of the total 210 DMA (Designated Market Area) markets. In 70 of the 156 markets, the Company has only one Barnes & Noble store. The Company believes its bookstores' proximity to their customers strengthen its market position and increase its franchise value. Most Barnes & Noble bookstores are located in high-traffic areas with convenient access to major commercial thoroughfares and ample parking. Most stores offer extended shopping hours, generally 9:00 a.m. to 11:00 p.m., seven days a week.

Dominant Title Selection. Each Barnes & Noble store features an authoritative selection of books, ranging between 60,000 to 200,000 titles, and has access to one million titles for immediate delivery. The comprehensive title selection is diverse and reflects local interests. In addition, Barnes & Noble emphasizes books published by small and independent publishers and university presses. Bestsellers represent only three percent of Barnes & Noble bookstore sales. Complementing this extensive on-site selection, all Barnes & Noble bookstores provide customers with access to the millions of books available to online shoppers while offering an option to have the book sent to the store or shipped directly to the customer. The Company believes that its tremendous selection, including many otherwise hard-to-find titles, builds customer loyalty.

Store Design and Ambiance. Many of the Barnes & Noble bookstores create a comfortable atmosphere with ample public space; a café offering, among other things, sandwiches and bakery items; and public restrooms. The cafés, for which the Starbucks Corporation is the sole provider of coffee products, foster the image of the bookstores as a community meeting place. In addition, the Company continues to develop and introduce new product line extensions, such as gift, game, music, video, DVD and children's sections, to meet customers' changing tastes and needs. These offerings and services have helped to make many of the stores neighborhood institutions.

Music Departments. Many of the Barnes & Noble bookstores have music departments, which range in size from 1,700 to 7,800 square feet. The music departments generally stock over 50,000 titles in classical music, opera, jazz, blues and pop rock and an extensive collection of DVD's, tailored to the tastes of the Company's core customers. Listening stations are available for customers to preview compact discs.

Discount Pricing. Barnes & Noble bookstores employ an aggressive nationwide discount pricing strategy. The current pricing is 30 percent off publishers' suggested retail prices for hardcover bestsellers, 30 percent off paperback bestsellers and 20 percent off select feature titles

[Table of Contents](#)

in departments such as children's books and computer books. The Company believes that its pricing strategies enable the Company to increase the discount on the books its customers buy most often while bringing the Company closer to online pricing.

The Company also offers Readers' Advantage™ memberships which entitle the customer to receive a ten percent discount in the Company's stores and a five percent discount on the Barnes & Noble.com Web site. Readers' Advantage™ also offers other benefits and invitations to member-only events.

Marketing and Community Relations. Barnes & Noble stores are launched with a major grand opening campaign involving extensive print and radio advertising, direct-mail marketing and community events. Each store plans its own community-based calendar of events, including author appearances, children's storytelling hours, poetry readings and discussion groups. The Company believes its community focus encourages customer loyalty, word-of-mouth publicity and media coverage. The Company also supports communities through efforts on behalf of local non-profit organizations that focus on literacy, the arts or education (K-12). In addition, the Company is the exclusive book sponsor of the Poets & Writers organization, and a co-sponsor with the Anti-Defamation League of "Close the Book on Hate," a national public education campaign that has been teaching children, young people and adults to accept and celebrate diversity through reading and discussion, helping to end prejudice and discrimination.

Merchandising and Marketing

The Company's merchandising strategy for its Barnes & Noble bookstores is to be the authoritative community bookstore which carries a dominant selection of titles in all subjects, including an extensive selection of titles from small independent publishers and university presses. Each Barnes & Noble store stocks from 60,000 to 200,000 titles, of which approximately 50,000 titles are common to all stores; the balance is crafted to reflect the lifestyles and interests of each store's customers. Before a store opens, the Company's buyers study the community and customize the title selection with offerings from the store's local publishers and authors. After the store opens, each Barnes & Noble store manager is responsible for adjusting the buyers' selection to the interests, lifestyles and demands of the store's local customers. BookMaster, the Company's proprietary inventory management database, has more than three million titles. It includes catalogued sales rankings of over one million titles in over 150 subjects and provides each store with comprehensive title selections in those subjects in which it seeks to expand. By enhancing the Company's existing merchandise replenishment systems, BookMaster allows the Company to achieve high in-stock positions and productivity at the store level through efficiencies in receiving, cashing and returns processing.

Store Locations and Properties

The Company's experienced real estate personnel select sites for new Barnes & Noble stores after an extensive review of demographic data and other information relating to market potential, bookstore visibility and access, available parking, surrounding businesses, compatible nearby tenants, competition and the location of other Barnes & Noble stores. Most stores are located in high-visibility areas adjacent to main traffic corridors in strip shopping centers or freestanding buildings. The Company has successfully converted existing structures such as old movie theaters, bowling alleys, power plants and landmark buildings into bookstores.

[Table of Contents](#)

The number of Barnes & Noble stores located in each state and the District of Columbia as of February 1, 2003 are listed below:

STATE	NUMBER OF STORES
Alabama	6
Alaska	1
Arizona	15
Arkansas	3
California	84
Colorado	14
Connecticut	11
Delaware	1
Dist. Of Columbia	2
Florida	42
Georgia	15
Hawaii	1
Idaho	3
Illinois	29
Indiana	10
Iowa	5
Kansas	4
Kentucky	7
Louisiana	7
Maine	1
Maryland	10
Massachusetts	19
Michigan	19
Minnesota	20
Mississippi	2
Missouri	9
Montana	4
Nebraska	4
Nevada	4
New Hampshire	4
New Jersey	22
New Mexico	2
New York	40
North Carolina	17
North Dakota	2
Ohio	18
Oklahoma	5
Oregon	8
Pennsylvania	24
Rhode Island	2
South Carolina	9
South Dakota	1
Tennessee	8
Texas	56
Utah	9
Vermont	1
Virginia	20
Washington	17
Wisconsin	10
Wyoming	1

Expansion

According to Veronis, Suhler & Associates Communications Industry Forecast (Veronis Suhler), total U.S. consumer spending on books is expected to increase at a compound annual growth rate of 2.8%, from approximately \$17.8 billion in 2001 to approximately \$20.5 billion in 2006. The Company believes Barnes & Noble bookstores offer the greatest opportunity to increase the Company's share of the expanding consumer book market. The Company expects to open approximately 35 to 40 new stores during fiscal 2003. All stores will be opened under the Barnes & Noble Booksellers trade name and management positions in those stores are expected to be filled mostly by employees from existing stores.

B. Dalton Bookstores

General

The Company is the second largest operator of mall bookstores in the United States.* During fiscal 2002, B. Dalton (including Doubleday and Scribner's) generated sales of approximately \$260.0 million, or 6.6% of the Company's total bookstore sales, compared with \$310.3 million, or 8.3% of total bookstore sales during fiscal 2001.

Most of the 258 B. Dalton stores range in size from 2,000 to 6,000 square feet. These stores stock between 20,000 and 25,000 titles. B. Dalton generally discounts hardcover and paperback bestsellers at 30% off the publishers' suggested retail prices. B. Dalton also offers Readers' Advantage™, a membership loyalty program which gives members additional discounts and other benefits. The Company's five Doubleday bookstores and one Scribner's bookstore utilize a more upscale format in select shopping malls and place a greater emphasis on hardcover and gift books.

The Company is continuing to execute a strategy to maximize returns from its B. Dalton stores in response to declining sales attributable primarily to superstore competition. Part of the Company's strategy has been to close underperforming stores as leases come up for renewal. In fiscal 2002, the Company closed 47 B. Dalton stores.

Merchandising and Marketing

Each B. Dalton store carries a selection of core titles within a variety of popular subject categories such as business, computers, cooking and reference, which are supplemented by new releases, bestsellers and other titles specially selected to meet local interests and demands. B. Dalton's merchandise strategy is to expand title assortments within categories it believes have significant growth potential, such as children's books, mass market paperbacks (such as mystery, romance, science fiction and other popular fiction), publishers' remainders and other bargain books including the Company's self-published books. B. Dalton's product offerings are tailored to attract shoppers interested in movies, television talk show topics and current events.

Store Locations and Properties

Approximately 89 percent of B. Dalton stores are located in enclosed regional shopping malls. The remaining stores are located in strip shopping centers and central business districts. Lease renewals for B. Dalton stores are made after an extensive review of financial results, demographic data, mall tenants, location within the mall and competitive factors.

* Based upon sales reported in trade publications and public filings.

[Table of Contents](#)

The number of B. Dalton stores located in each state and the District of Columbia as of February 1, 2003 are listed below:

STATE	NUMBER OF STORES
Alabama	1
Arizona	6
Arkansas	1
California	35
Colorado	2
Connecticut	1
Dist. Of Columbia	1
Florida	12
Georgia	7
Idaho	3
Illinois	13
Indiana	5
Iowa	6
Kansas	5
Kentucky	1
Louisiana	5
Maine	2
Maryland	5
Massachusetts	3
Michigan	13
Minnesota	11
Mississippi	1
Missouri	7
Nebraska	1
Nevada	3
New Hampshire	2
New Jersey	8
New Mexico	2
New York	9
North Carolina	5
North Dakota	3
Ohio	13
Oklahoma	1
Oregon	4
Pennsylvania	11
South Carolina	3
South Dakota	1
Tennessee	1
Texas	16
Utah	5
Virginia	10
Washington	7
West Virginia	1
Wisconsin	4
Wyoming	2

Barnes & Noble.com

General

The Company currently has an approximate 38 percent ownership interest in Barnes & Noble.com, a leading internet-based retailer of books, music, DVD/video and online courses. Since opening its online store (www.bn.com) in March 1997, Barnes & Noble.com has attracted more than 13.6 million customers in 232 countries. Barnes & Noble.com's bookstore includes the largest in-stock selection of in-print book titles with access to approximately one million titles for immediate delivery, supplemented by more than 30 million listings from its nationwide network of out-of-print, rare and used book dealers. Barnes & Noble.com offers its customers fast delivery, easy and secure ordering and rich editorial content.

According to Jupiter Media Metrix, in December 2002, Barnes & Noble.com's Web site was the ninth most-trafficked shopping site and was among the top 50 largest Web properties on the Internet. Co-marketing agreements with major Web portals such as AOL, Yahoo! and MSN as well as content sites have extended Barnes & Noble.com's brand and increased consumer exposure to its site. Barnes & Noble.com has also established a network of remote virtual storefronts across the Internet by creating direct links with more than 176,000 affiliate Web sites.

GameStop Stores

General

The Company acquired Babbage's Etc. and Funco, Inc. in October 1999 and June 2000, respectively. Through a corporate restructuring, Babbage's Etc. became a wholly owned subsidiary of Funco, Inc. and the name of Funco, Inc. was changed to GameStop, Inc. In February 2002, the Company completed an initial public offering for its GameStop subsidiary. The Company retained an approximate 63 percent interest in GameStop. GameStop is the nation's largest video-game and PC-entertainment software specialty retailer*, operating 1,231 video-game and entertainment-software stores located in 49 states, Puerto Rico and Guam as of February 1, 2003. The video-game and entertainment-software stores range in size from 500 to 5,000 square feet (averaging 1,500 square feet) depending upon market demographics. Stores feature video-game hardware and software, PC-entertainment software and a multitude of accessories. GameStop operates stores under the GameStop, Babbage's, Software Etc. and FuncoLand trade names, a Web site, gamestop.com, and *Game Informer* magazine (collectively, GameStop or Video Game & Entertainment Software).

Of the 1,231 stores, 693 stores are located in strip centers and 538 stores are located in shopping malls and other locations. Strip center stores carry a balanced mix of new and used video-game products and, in selected stores, PC-entertainment software. Mall stores carry primarily new video-game products and PC-entertainment software, as well as a limited selection of used video game products. GameStop is the largest retailer of used video games in the nation and provides customers with the opportunity to trade in their used video game products in exchange for store credits which can be applied towards the purchase of other products, including new merchandise. The trade-in program provides a unique value proposition to customers which is unavailable at mass merchants, toy stores and consumer electronics retailers.

Merchandising and Marketing

The mall stores primarily focus on the electronic game enthusiast who demands the latest merchandise featuring the "hottest" technology immediately on the day of release. The strip center stores also serve the electronic game enthusiast, but focus on serving the value-oriented customer by offering a wide selection of value-priced used video-game products and the opportunity to trade in used video-game products in exchange for store credits applicable to future purchases, which, in turn, drives more sales.

Store Locations and Properties

GameStop has a dedicated staff of real estate personnel experienced in selecting store locations. Site selections for new stores are made after an extensive review of demographic data and other information relating to market potential, competitor access and visibility, compatible nearby tenants, accessible parking, location visibility, lease terms and the location of other GameStop stores. Most GameStop stores are located in highly visible locations within malls and strip centers.

* Based upon sales reported in trade publications and public filings.

[Table of Contents](#)

The number of video-game and entertainment-software stores located in each state, the Commonwealth of Puerto Rico and Guam as of February 1, 2003 are listed below:

STATE	NUMBER OF STORES
Alabama	11
Alaska	3
Arizona	22
Arkansas	4
California	137
Colorado	19
Connecticut	16
Delaware	6
Florida	54
Georgia	26
Guam	1
Hawaii	10
Idaho	2
Illinois	71
Indiana	18
Iowa	9
Kansas	5
Kentucky	15
Louisiana	11
Maine	2
Maryland	36
Massachusetts	28
Michigan	54
Minnesota	25
Mississippi	4
Missouri	28
Montana	4
Nebraska	3
Nevada	12
New Hampshire	6
New Jersey	62
New Mexico	5
New York	60
North Carolina	20
North Dakota	4
Ohio	53
Oklahoma	10
Oregon	8
Pennsylvania	69
Puerto Rico	11
Rhode Island	1
South Carolina	12
South Dakota	2
Tennessee	18
Texas	136
Utah	16
Vermont	1
Virginia	38
Washington	34
West Virginia	9
Wisconsin	20

Expansion

GameStop intends to continue to open new strip center stores in targeted markets and new mall stores in selected mall locations. GameStop opened 210 new stores in fiscal 2002 and 74 new stores in fiscal 2001. GameStop plans on opening approximately 235 to 265 new stores in fiscal 2003. The primary growth vehicle will be the expansion of the strip center store base, which is believed could grow to over 2,000 stores in the United States. GameStop's strategy is to open clusters of strip center stores in targeted major metropolitan markets under the GameStop brand name. GameStop analyzes each market relative to target population and other demographic indices, real estate availability, competitive factors and past operating history, if available.

During fiscal 2002, GameStop successfully capitalized on the growth in demand for video game software and accessories that followed the launch of four new video game platforms and the related increase in installed hardware base. Over the next few years, GameStop expects to continue to capitalize on the increasing installed base for these platforms and the related growth in video game software and accessories sales.

Other Strategies

Proprietary Publishing. Barnes & Noble differentiates its product offerings from those of its competitors by publishing books under its own imprints. As part of this activity, Barnes & Noble licenses titles directly from domestic and international publishers as well as from literary agents, commissions books directly from authors, reprints classic titles in the public domain and creates collections of fiction and non-fiction using in-house editors. The Company, through its January 2003 acquisition of Sterling Publishing Co., Inc. (Sterling), is one of the top 25 publishers in the nation and the industry's leading publisher of how-to books. Sterling has an active list of more than 4,500 owned and distributed titles, and publishes and distributes more than 1,000 new titles annually. As a leading publisher of how-to books, Sterling has strength in art technique, gardening, cooking, health, crafts, puzzle and game, woodworking and house and home. With the addition of the Sterling titles, the Company has publishing or distribution rights to nearly 10,000 titles and offers customers high quality books at exceptional values, while generating attractive gross margins. By self-publishing books, the Company is able to significantly lower its merchandise costs and pass on a portion of the savings to its customers. While the prices of these books represent significant value to the customers, they also generate substantially higher gross profit margins than those realized on sales of non-proprietary books.

Strategic Investments

The Company also owns a 74 percent interest in Calendar Club L.L.C., an operator of seasonal calendar kiosks.

Store Operations

The Company has seasoned management teams for its Barnes & Noble, B. Dalton and GameStop stores, including those for real estate, merchandising and store operations. Field management includes regional directors and district managers supervising multiple store locations.

Each Barnes & Noble store generally employs a manager, two assistant managers and approximately 50 full- and part-time booksellers. Many Barnes & Noble stores also employ a full-time community relations manager. Each GameStop store employs, on average, one manager, one assistant manager and between two and 10 sales associates, many of whom are part-time employees. Each B. Dalton store generally employs a manager, an assistant manager and approximately seven full- and part-time booksellers. The large employee base provides the Company with experienced booksellers and interactive gaming experts to fill positions in the Company's new Barnes & Noble and GameStop stores. The Company anticipates that a significant percentage of the personnel required to manage its expanding business will continue to come from within its existing operations.

Field management for all of the Company's bookstores and GameStop stores, including regional directors, district managers and store managers, participate in an incentive program tied to store productivity. The Company believes that the compensation of its field management is competitive with that offered by other specialty retailers of comparable size.

Barnes & Noble, B. Dalton and GameStop have in-store training programs providing specific information needed for success at each level, beginning with the entry-level positions of bookseller and game advisor. Store managers attend annual merchandising conferences every

[Table of Contents](#)

fall, and district managers participate in semi-annual training and merchandising conferences. GameStop's training program incorporates an element of on-the-job training where existing store managers train new store managers in all areas of store operations. Barnes & Noble and B. Dalton store managers are generally responsible for training other booksellers and employees in accordance with detailed procedures and guidelines prescribed by the Company, utilizing training aids available at each bookstore.

Purchasing

Barnes & Noble's buyers negotiate terms, discounts and cooperative advertising allowances with publishers for all of the Company's bookstores. The Company's distribution centers enable it to maximize available discounts and enhance its ability to create marketing programs with many of its vendors. The Company has teams of buyers who specialize in customizing inventory for each of the Company's bookselling strategies. Store inventories are further customized by store managers, who may respond to local demand by purchasing a limited amount of fast-selling titles through a nationwide wholesaling network.

The Company purchases books on a regular basis from over 1,700 publishers and approximately 45 wholesale distributors. Purchases from the top five suppliers (including publishers and wholesale distributors) accounted for approximately 44 percent of the Company's book purchases during fiscal 2002, and no single supplier accounted for more than 15 percent of the Company's purchases during this period. Consistent with retail book industry practice, substantially all of the Company's book purchases are returnable for full credit, a practice which substantially reduces the Company's risk of inventory obsolescence.

Publishers control the distribution of titles by virtue of copyright protection, which limits availability on most titles to a single publisher. Since the retail, or list, prices of titles, as well as the retailers' cost price, are also generally determined by publishers, the Company has limited options concerning availability, cost and profitability of its book inventory. However, these limitations are mitigated by the substantial number of titles available, the Company's ability to maximize available discounts and its well-established relationships with publishers, which are enhanced by the Company's significant purchasing volume.

Publishers periodically offer their excess inventory in the form of remainder books to book retailers and wholesalers through an auction process which generally favors booksellers such as the Company who are able to buy substantial quantities. These books are generally purchased in large quantities at favorable prices and are then sold to consumers at significant discounts off publishers' list prices.

GameStop purchases substantially all of its new products from approximately 85 manufacturers and software publishers and approximately five distributors. Purchases from the top five vendors accounted for approximately 55% of GameStop's new product purchases in fiscal 2002. Only Sony and Electronic Arts (which accounted for 18% and 12%, respectively) accounted for more than 10% of GameStop's new product purchases during fiscal 2002. GameStop has established price protections and return privileges with its primary vendors in order to reduce the risk of inventory obsolescence. In addition, GameStop has no purchase contracts with trade vendors and conducts business on an order-by-order basis, a practice that is typical throughout the industry. GameStop believes that maintaining and strengthening its long-term relationships with its vendors is essential to its operations and continued expansion. GameStop believes it has very good relations with its vendors.

Distribution

The Company has invested significant capital in its systems and technology by building new platforms, implementing new software applications and maintaining efficient distribution centers. As of February 1, 2003, the Company's book distribution centers had over one and a half million square feet. In fiscal 2002, the Company added over 500,000 square feet when its distribution center in Reno, Nevada became fully operational. The Company is using the Reno facility to facilitate distribution to its West Coast stores. Historically, the Company had replenished through its distribution network some of its fast-moving frontlist titles and bargain and self-published books and had the remaining inventory drop-shipped directly to the stores from wholesalers and publishers. The Company now sources more of its inventory through the distribution centers, which has increased direct buying from publishers rather than wholesalers. This has also led to improved just-in-time deliveries to stores.

GameStop operates a 210,000 square foot state-of-the-art distribution center in Grapevine, Texas. By operating with a centralized distribution facility, GameStop effectively controls and minimizes inventory levels. A technologically-advanced conveyor system and flow-through racks control costs and improve speed of fulfillment. The technology used in the distribution center allows for high-volume receiving, distributions to stores and returns to vendors. Inventory is shipped to each store at least twice a week, or daily, if necessary, in order to keep stores in supply of products. In order to support its first-to-market distribution network, GameStop utilizes the services of ten off-site, third-party operated distribution centers that pick up products from suppliers, repackage the products for each of the stores and ship products to the stores by package carriers. GameStop's ability to rapidly process incoming shipments of new release titles and distribute them to all of the stores, either that day or by the next morning, enables GameStop to meet peak demand and replenish stores at least twice a week.

Management Information and Control Systems

The Company has focused a majority of its information resources on strategically positioning and implementing systems to support store operations, merchandising and finance. BookMaster, the Company's bookstore inventory management system, integrates point-of-sale features that utilize a proprietary data-warehouse based replenishment system. BookMaster enhances communications and real-time access to the Company's network of bookstores, distribution centers and wholesalers. In addition, the implementation of just-in-time replenishment has provided for more rapid replenishment of books to all of the Company's bookstores, resulting in higher in-stock positions and better productivity at the bookstore level through efficiencies in receiving, cashiering and returns processing.

GameStop's proprietary inventory management system and point-of-sale technology show daily sales and in-store stock by title by store. Systems in place use this data to automatically generate replenishment shipments to each store from GameStop's distribution center in Grapevine, Texas, enabling each store to carry a merchandise assortment uniquely tailored to its own sales mix and rate of sale. GameStop's call lists and reservation system also provide the centralized buying staff with information to determine order size and inventory management for store-by-store inventory allocation. GameStop constantly reviews and edits its merchandise categories with the objective of ensuring that inventory is up-to-date and meets customer needs. GameStop uses a centralized PC network-based information system based in its

[Table of Contents](#)

corporate offices, in order to minimize initial outlay of capital while allowing for flexibility and growth as operations expand.

The Company continues to implement systems to improve efficiencies in back office processing in the human resources, finance and merchandising areas. An offsite business recovery capability has been developed and implemented to assure uninterrupted systems support.

Competition

The retail book business is highly competitive. The Company competes in the superstores business with Borders Group, Inc. (Borders) and Books-a-Million. The Company also faces competition from mass merchandisers, such as Wal-Mart and Costco, some of which may have greater financial and other resources than the Company. B. Dalton Bookseller, Doubleday Book Shops and Scribner's Bookstores face direct competition from the Walden division of Borders, as well as regional chains and superstores. The Company's bookstores also compete with specialty retail stores that offer books in particular subject areas, independent single store operators, variety discounters, drug stores, warehouse clubs, mail-order clubs and other retailers offering books and music. In addition, the Company's bookstores may also face competition from the expanding market for electronic books.

The electronic game industry is intensely competitive and subject to rapid changes in consumer preferences and frequent new product introductions. GameStop competes with mass merchants and regional chains, including Wal-Mart, Target and Kmart; other video game and PC software specialty stores located in malls and other locations, including Electronics Boutique; toy retail chains, including Toys "R" Us and KB Toys; mail-order businesses; catalogs; direct sales by software publishers; online retailers; and computer product and consumer electronics superstores, including Best Buy and Circuit City. In addition, video games are available for rental from many video stores, some of whom have increased the availability of video game products for sale. Video game products may also be distributed through other methods which may emerge in the future. GameStop also competes with sellers of used video game products. Additionally, GameStop competes with other forms of entertainment activities, including movies, television, theater, sporting events and family entertainment centers.

The Company also faces competition from the Internet. The online commerce market is rapidly evolving and intensely competitive, having few barriers to entry. The Company believes that many small Web sites and several large Web sites currently offer and sell most of the same products the Company offers. Moreover, companies that control access to Internet commerce transactions through network access or Web browsers currently promote, and will likely continue to promote, certain of the Company's competitors. The Company is aware that some of its competitors have and may continue to adopt aggressive pricing or inventory availability policies and devote substantially more resources to Web site and systems development than the Company.

Trademarks and Servicemarks

B. Dalton Bookseller, Bookstar, Readers' Advantage, Book\$avers, GameStop, *Game Informer*, Babbage's and FuncoLand are Company-owned service marks registered with the United States Patent and Trademark Office. Barnes & Noble, Doubleday Book Shops and Scribner's Bookstores are federally registered service marks which have been licensed to the

[Table of Contents](#)

Company under long-term license agreements which are royalty-free. These license agreements provide the Company with the exclusive right to use the Doubleday and Scribner's service marks only in connection with the retail sale of books.

Seasonality

The Company's business, like that of many retailers, is seasonal, with the major portion of sales and operating profit realized during the quarter which includes the holiday selling season.

Employees

The Company's bookstores cultivate a culture of outgoing, helpful and knowledgeable employees. GameStop's stores cultivate a work environment that attracts knowledgeable employees who are actively interested in video games and entertainment software. As of February 1, 2003, the Company had approximately 39,000 full- and part-time booksellers. As of February 1, 2003, GameStop employed approximately 11,000 full- and part-time employees in its stores. The Company's employees are not represented by unions, with the exception of 35 Sterling employees, and the Company believes that its relationship with its employees is excellent.

Available Information

The Company makes available on its Web site (<http://www.barnesandnobleinc.com>) under "Financials" — "SEC Documents", free of charge, its annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports as soon as reasonably practicable after the Company electronically files or furnishes such material with the Securities and Exchange Commission.

ITEM 2. PROPERTIES

All but two of the Barnes & Noble stores are leased. The leases typically provide for an initial term of 10 or 15 years with one or more renewal options. The terms of the Barnes & Noble store leases for its 626 leased stores open as of February 1, 2003 expire as follows:

Lease Terms to Expire During	Number of Stores
(12 months ending on or about January 31)	
2004	20
2005	40
2006	32
2007	19
2008	36
2009 and later	479

[Table of Contents](#)

All B. Dalton stores are leased. The leases generally provide for an initial 10 year term with no renewal option. The terms of the 258 B. Dalton leases as of February 1, 2003 expire as follows:

Lease Terms to Expire During	Number of Stores
(12 months ending on or about January 31)	
2004	117
2005	45
2006	49
2007	16
2008	16
2009 and later	15

All GameStop stores are leased. The leases generally provide for an initial term of three to 10 years with renewal options. The terms of the 1,231 GameStop leases as of February 1, 2003 expire as follows:

Lease Terms to Expire During	Number of Stores
(12 months ending on or about January 31)	
Expired and in negotiations	138
2004	217
2005	191
2006	179
2007	102
2008 and later	404

The Company generally has been able to renew expiring leases on favorable terms, and believes that renewals of leases expiring in the future will not have a material adverse effect on its financial condition or results of operations.

ITEM 3. LEGAL PROCEEDINGS

In August 1998, The Intimate Bookshop, Inc. and its owner, Wallace Kuralt, filed a lawsuit in the United States District Court for the Southern District of New York against the Company, Borders Group, Inc. and others, alleging violation of the Robinson-Patman Act and other federal law, New York statutes governing trade practices and common law. In March 2000, a Second Amended Complaint was served on the Company and other defendants alleging a single cause of action for violations of the Robinson-Patman Act. The Second Amended Complaint claims that The Intimate Bookshop, Inc. has suffered damages of \$11,250,000 or more and requests treble damages, costs, attorneys' fees and interest, as well as declaratory and injunctive relief prohibiting the defendants from violating the Robinson-Patman Act. The Company served an Answer in April 2000 denying the material allegations of the Second Amended Complaint and asserting various affirmative defenses. On January 11, 2002, the Company and the other defendants filed a motion for summary judgment. A hearing on that motion was held on March 22, 2002. The Company intends to vigorously defend this action.

[Table of Contents](#)

On March 14, 2003, a Company employee filed a class action lawsuit against the Company in the Superior Court of California for the County of Orange (Case No. 03CC00088). The complaint alleges that the Company improperly classified the assistant store managers, department managers and receiving managers working in its California stores as salaried exempt employees. The complaint alleges that these employees spent more than 50 percent of their time performing non-exempt work and should have been classified as non-exempt employees. The complaint alleges violations of the California Labor Code and California Business and Professions Code and seeks relief, including unpaid overtime compensation, prejudgment interest, penalties, attorneys' fees and costs. The Company intends to vigorously defend this action, including contesting its certification as a class action.

In addition to the above actions, various claims and lawsuits arising in the normal course of business are pending against the Company. The subject matter of these proceedings primarily includes commercial disputes, personal injury claims and employment issues. The results of these proceedings are not expected to have a material adverse effect on the Company's consolidated financial position or results of operations.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

There were no matters submitted to a vote of security holders during the 13 weeks ended February 1, 2003.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Price Range of Common Stock

The Company's common stock is traded on the New York Stock Exchange ("NYSE") under the symbol "BKS". The following table sets forth, for the quarterly periods indicated, the high and low sales prices of the common stock on the NYSE Composite Tape.

	Fiscal 2002		Fiscal 2001	
	High	Low	High	Low
First Quarter	\$33.90	28.36	\$33.61	23.40
Second Quarter	34.43	18.01	41.20	30.40
Third Quarter	24.50	18.40	43.99	32.84
Fourth Quarter	24.79	16.77	38.40	23.30

Approximate Number of Holders of Common Equity

Title of Class	Approximate Number of Record Holders as of March 31, 2003
Common stock, \$0.001 par value	2,043

Dividends

The terms of the Company's revolving credit agreement limit payment of cash dividends. During fiscal 2002 and fiscal 2001, the Company did not declare or pay any cash dividends or make distributions or payments on its common stock.

ITEM 6. SELECTED FINANCIAL DATA

The information included in the Company's Annual Report to Shareholders for the fiscal year ended February 1, 2003 (the Annual Report) under the section entitled "Selected Financial Data" is incorporated herein by reference.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The information included in the Annual Report under the section entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations" is incorporated herein by reference.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company limits its interest rate risks by investing certain of its excess cash balances in short-term, highly-liquid instruments with an original maturity of three months or less. The Company does not expect any material losses from its invested cash balances and the Company believes that its interest rate exposure is modest. As of February 1, 2003, the Company's cash and cash equivalents totaled approximately \$267,642,000.

Additionally, the Company may from time to time borrow money under its revolving credit facility at various interest-rate options based on the prime rate or the London Interbank Offer Rate (LIBOR) depending upon certain financial tests. Accordingly, the Company may be exposed to interest rate risk on money that it borrows under its credit facility. The amount outstanding under the facility has been classified as long-term debt in the consolidated balance sheets of the Company included in the Annual Report under the section entitled "Consolidated Balance Sheets," which is incorporated by reference herein. The Company did not have any amounts outstanding under the facility at February 1, 2003.

We do not have any foreign currency exposure as nearly all of the Company's business is transacted in United States currency.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The information included in the Annual Report under the sections entitled: "Consolidated Statements of Operations," "Consolidated Balance Sheets," "Consolidated Statements of Changes in Shareholders' Equity," "Consolidated Statements of Cash Flows" and "Notes to Consolidated Financial Statements" are incorporated herein by reference.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The information with respect to directors and executive officers of the Company is incorporated herein by reference to the Company's definitive Proxy Statement relating to the Company's 2002 Annual Meeting of Shareholders to be filed with the Securities and Exchange Commission within 120 days of the Company's fiscal year ended February 1, 2003 (the Proxy Statement).

The information with respect to compliance with Section 16(a) of the Securities Exchange Act is incorporated herein by reference to the Proxy Statement.

ITEM 11. EXECUTIVE COMPENSATION

The information with respect to executive compensation is incorporated herein by reference to the Proxy Statement.

The information with respect to compensation of directors is incorporated herein by reference to the Proxy Statement.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

Equity Compensation Plan Information

The following table sets forth equity compensation plan information as of February 1, 2003:

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities in column (a))
	(a)	(b)	(c)
Equity compensation plans approved by security holders	12,568,000	\$ 18.22	2,536,803
Equity compensation plans not approved by security holders	—	—	—
Total	12,568,000	\$ 18.22	2,536,803

The information with respect to security ownership of certain beneficial owners and management is incorporated herein by reference to the Proxy Statement.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information with respect to certain relationships and related transactions is incorporated herein by reference to the Proxy Statement.

ITEM 14. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures

Within the 90-day period prior to the date of this report, the Company carried out an evaluation of the effectiveness of the design and operation of its disclosure controls and procedures pursuant to the requirements of the Securities Exchange Act of 1934 (the "Exchange Act"), under the supervision and with the participation of the Company's Chief Executive Officer and Chief Financial Officer. Based on that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective. Disclosure controls and procedures are controls and procedures designed to ensure that information required to be disclosed in the Company's reports filed or submitted pursuant to the Exchange Act is recorded, processed, summarized and reported within the appropriate time periods.

(b) Changes in Internal Controls

There were no significant changes in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the date of the Company's last evaluation.

PART IV**ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K**

(a) 1. Consolidated Financial Statements:

- (i) "The Report of Independent Certified Public Accountants" included in the Annual Report is incorporated herein by reference.
- (ii) The information included in the Annual Report under the sections entitled: "Consolidated Statements of Operations," "Consolidated Balance Sheets," "Consolidated Statements of Changes in Shareholders' Equity," "Consolidated Statements of Cash Flows" and "Notes to Consolidated Financial Statements" are incorporated herein by reference.

(b) Reports filed on Form 8-K during the Company's quarter ended February 1, 2003.

- (1) On December 13, 2002, the Company filed a Form 8-K under Item 5 which announced that the Company had reached an agreement to purchase Sterling Publishing Co., Inc., a privately held company that is one of the top 25 publishers in the United States and a leading publisher of how-to books.
- (2) On January 23, 2003, the Company filed a Form 8-K under Items 5 and 7 announcing the completion of the purchase of the assets of Sterling Publishing Co., Inc. and submitting the press release dated January 22, 2003 which announced the purchase.

2. Schedule

Valuation and Qualifying Accounts.

As of February 1, 2003, February 2, 2002 and February 3, 2001

	Balance at beginning of period	Charged to costs and expenses	Charged to other accounts	Write- offs	Balance at end of period
Allowance for Doubtful Accounts at February 1, 2003	\$2,376,315	\$ 216,000	\$(353,346)	\$ 79,372	\$2,318,340
Allowance for Doubtful Accounts at February 2, 2002	\$1,716,169	\$1,252,390	—	\$592,244	\$2,376,315
Allowance for Doubtful Accounts at February 3, 2001	\$1,388,956	\$1,178,683	—	\$851,470	\$1,716,169

[Table of Contents](#)

3. Exhibits:

The following are filed as Exhibits to this form:

Exhibit No.	Description
3.1	Amended and Restated Certificate of Incorporation of the Company, as amended. (1)
3.2	Amendment to the Amended and Restated Certificate of Incorporation of the Company filed May 30, 1996. (2)
3.3	Amended and Restated By-laws of the Company. (1)
3.4	Amendment to the Company's By-laws adopted May 31, 1995. (3)
3.5	Certificate of Designation of Preferences and Rights of Preferred Stock, Series H of Barnes & Noble, Inc. (4)
3.6	Certificate of Amendment of The Amended and Restated Certificate of Incorporation of Barnes & Noble, Inc., dated July 17, 1998 and filed July 17, 1998. (4)
4.1	Specimen Common Stock certificate. (1)
4.2	Rights Agreement, dated as of July 10, 1998, between Barnes & Noble, Inc. and The Bank of New York, as Rights Agent. (4)
10.1	Supplemental Compensation Plan. (6)
10.2	License Agreement for "Barnes & Noble" service mark, dated as of February 11, 1987. (1)
10.3	Consents to "Barnes & Noble" License Agreement Assignments, dated as of November 18, 1988 and November 16, 1992, respectively. (5)
10.4	Employment Agreement between the Company and Mitchell S. Klipper dated as of February 18, 2002. (15)
10.5	Employment Agreement between the Company and Stephen Riggio, dated as of February 18, 2002. (19)
10.6	Amended and Restated Limited Liability Company Agreement of barnesandnoble.com llc (the "LLC Agreement") among Barnes & Noble, Inc., B&N.com Holding Corp., Bertelsmann AG and BOL.US Online, Inc. (7)
10.7	Amendment No. 1 to the LLC Agreement. (9)
10.8	Supply Agreement, dated as of October 31, 1998, between Barnes & Noble, Inc. and barnesandnoble.com llc. (8)
10.9	Indenture, dated as of March 14, 2001, between Barnes & Noble, Inc. and United States Trust

[Table of Contents](#)

Exhibit No.	Description
	Company of New York, as Trustee. (12)
10.10	Registration Rights Agreement, dated as of March 8, 2001, between Barnes & Noble, Inc. and Credit Suisse First Boston Corporation and Merrill Lynch, Pierce, Fenner & Smith Incorporated. (12)
10.11	Revolving Credit Agreement, dated as of May 22, 2002, among Barnes & Noble, Inc., Fleet National Bank, as Administrative Agent, and the Banks party thereto (the "Banks"). (16)
10.12	Security Agreement, dated as of May 22, 2002, between Barnes & Noble, Inc. and its wholly owned subsidiaries (the "Subsidiaries") and Fleet National Bank, as secured party and as administrative agent for itself and the Banks. (16)
10.13	Securities Collateral Pledge Agreement, dated as of May 22, 2002, between Barnes & Noble, Inc. and its Subsidiaries and Fleet National Bank, as secured party and as administrative agent for itself and the Banks. (16)
10.14	Patent and Trademark Security Agreement, dated as of May 22, 2002, between Barnes & Noble, Inc. and its Subsidiaries and Fleet National Bank, as secured party and as administrative agent for itself and the Banks. (16)
10.15	Subsidiary Guaranty, dated as of May 22, 2002, between each of the Subsidiaries and Fleet National Bank, as secured party and as administrative agent for itself and the Banks. (16)
10.16	Barnes & Noble, Inc. Amended and Restated 1996 Incentive Plan, incorporated by reference to Exhibit 4.1 of Form S-8 filed with the Securities and Exchange Commission on June 14, 2002. (17)
10.17	Amendment No. 1 dated August 29, 2002 to Revolving Credit Agreement, dated as of May 22, 2002, among Barnes & Noble, Inc., Fleet National Bank, as Administrative Agent, and the Banks party thereto. (18)
13.1	The sections of the Company's Annual Report entitled: "Selected Financial Data", "Management's Discussion and Analysis of Financial Condition and Results of Operations", "Consolidated Statements of Operations", "Consolidated Balance Sheets", "Consolidated Statements of Changes in Shareholders' Equity", "Consolidated Statements of Cash Flows", "Notes to Consolidated Financial Statements" and "The Report of Independent Certified Public Accountants". (19)
21.1	List of subsidiaries. (19)
23.1	Consent of BDO Seidman, LLP. (19)
23.2	Report of BDO Seidman, LLP. (19)

[Table of Contents](#)

Exhibit No.	Description
99.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, executed by Stephen Riggio, Chief Executive Officer of Barnes & Noble, Inc. (19)
99.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, executed by Lawrence S. Zilavy, Chief Financial Officer of Barnes & Noble, Inc. (19)

Table of Contents

- (1) Previously filed as an exhibit to the Company's Registration Statement on Form S-4 (Commission File No. 33-59778) and incorporated herein by reference.
- (2) Previously filed as an exhibit to the Company's Form 10-Q for the fiscal quarter ended April 27, 1996.
- (3) Previously filed as an exhibit to the Company's Form 10-Q for the fiscal quarter ended April 29, 1995.
- (4) Previously filed as an exhibit to the Company's Form 10-Q for the fiscal quarter ended August 1, 1998.
- (5) Previously filed as an exhibit to the Company's Form 10-K for the fiscal year ended January 27, 1996.
- (6) Previously filed as an exhibit to the Company's Form 10-Q for the fiscal quarter ended July 29, 1995.
- (7) Previously filed as an exhibit to the Company's Form 10-Q for the fiscal quarter ended October 31, 1998.
- (8) Previously filed as an exhibit to the Company's Form 10-K for the fiscal year ended January 30, 1999.
- (9) Previously filed as an exhibit to the Company's Form 10-K for the fiscal year ended January 29, 2000.
- (10) Previously filed as an exhibit to the Company's Form 8-K filed with the Securities and Exchange Commission on May 10, 2000.
- (11) Previously filed as an exhibit to the Company's Form 10-Q for the fiscal quarter ended October 28, 2000.
- (12) Previously filed as an exhibit to the Company's Form 8-K filed with the Securities and Exchange Commission on March 22, 2001.
- (13) Previously filed as an exhibit to the Company's Form 10-Q for the fiscal quarter ended May 5, 2001.
- (14) Previously filed as an exhibit to the Company's Form 10-K for the fiscal year ended February 3, 2001.
- (15) Previously filed as an exhibit to the Company's Form 10-K for the fiscal year ended February 2, 2002.
- (16) Previously filed as an exhibit to the Company's Form 10-Q for the fiscal quarter ended May 4, 2002.

[Table of Contents](#)

- (17) Previously filed as an exhibit to the Company's Form 10-Q for the fiscal quarter ended August 3, 2002.
- (18) Previously filed as an exhibit to the Company's Form 10-Q for the fiscal quarter ended November 2, 2002.
- (19) Filed herewith.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

BARNES & NOBLE, INC.

(Registrant)

By: /s/Joseph J. Lombardi

Joseph J. Lombardi
Vice President, Controller
(principal accounting officer)
April 23, 2003

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<u>Name</u>	<u>Title</u>	<u>Date</u>
<u>/s/ Leonard Riggio</u> Leonard Riggio	Chairman of the Board	April 23, 2003
<u>/s/ Stephen Riggio</u> Stephen Riggio	Vice Chairman and Chief Executive Officer (principal executive officer)	April 23, 2003
<u>/s/Lawrence S. Zilavy</u> Lawrence S. Zilavy	Chief Financial Officer (principal financial officer)	April 23, 2003
<u>/s/ Michael N. Rosen</u> Michael N. Rosen	Secretary and Director	April 23, 2003
<u>/s/ Matthew A. Berdon</u> Matthew A. Berdon	Director	April 23, 2003
<u>/s/ Michael J. Del Giudice</u> Michael J. Del Giudice	Director	April 23, 2003
<u>/s/ William Dillard II</u> William Dillard II	Director	April 23, 2003
<u>/s/ Irene R. Miller</u> Irene R. Miller	Director	April 23, 2003

/s/ Margaret T. Monaco

Director

April 23, 2003

Margaret T. Monaco

/s/ William Sheluck, Jr.

Director

April 23, 2003

William Sheluck, Jr.

CERTIFICATION

I, Stephen Riggio, certify that:

1. I have reviewed this annual report on Form 10-K of Barnes & Noble, Inc.;
 2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
 3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
 4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - a. designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
 - b. evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and
 - c. presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
 5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
 - a. all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
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[Table of Contents](#)

6. The registrant's other certifying officer and I have indicated in this annual report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: April 23, 2003

/s/Stephen Riggio

Stephen Riggio
Chief Executive Officer

CERTIFICATION

I, Lawrence S. Zilavy, certify that:

1. I have reviewed this annual report on Form 10-K of Barnes & Noble, Inc.;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - a. designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
 - b. evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and
 - c. presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
 - a. all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

[Table of Contents](#)

6. The registrant's other certifying officer and I have indicated in this annual report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: April 23, 2003

/s/Lawrence S. Zilavy

Lawrence S. Zilavy
Chief Financial Officer

Exhibit 10.5

BARNES & NOBLE, INC.

122 Fifth Avenue

New York, New York 10011

As of February 18, 2002

Mr. Stephen Riggio
81 Post Kunhardt Road
Bernardsville, New Jersey 07924

Dear Mr. Riggio:

This letter agreement is intended to set forth our mutual understanding regarding your employment as Chief Executive Officer of Barnes & Noble, Inc. (the "Company"). Accordingly, we are pleased to agree as follows:

1. Employment; Duties. You agree to be Chief Executive Officer of the Company for the term of this Agreement. In this capacity you shall perform such duties and have such responsibilities as are typically associated with the office of Chief Executive Officer, including such duties and responsibilities as are prescribed by the Board of Directors of the Company (the "Board") consistent with the office of Chief Executive Officer. While you are the Company's employee, you agree to devote your full business time and attention to the performance of your duties and responsibilities hereunder.

2. Term. (a) Unless terminated earlier in accordance with the provisions set forth below, the term of this Agreement will be for a period beginning on the date hereof and ending on the third anniversary of the date hereof. At the expiration (but not earlier termination) of the term (including any renewal term), the term of this Agreement shall automatically renew for an additional period of one year, unless either party has given the other party written notice of non-renewal at least one year prior to such renewal.

(b) This Agreement shall terminate upon your death and may be terminated by the Company by written notice to you following your Disability (as defined below). This Agreement may also be terminated by the Company for Cause (as defined below) upon written notice to you. This Agreement may also be terminated by you for Good Cause (as defined below) upon written notice to the Company.

(c) For purposes of this Agreement:

(i) "Cause" shall mean (A) your final conviction of a felony impacting on the performance of your duties or involving a crime of moral turpitude, or (B) misappropriation or embezzlement in the performance of your duties as an employee of the Company, or (C) willfully engaging in conduct materially injurious to the Company and in violation of your obligations under this Agreement, which violation continues for at least 30 days after written notice thereof from the Company to you specifying such violation in reasonable detail.

(ii) "Disability" shall mean a written determination by a physician mutually agreeable to the Company and you (or, in the event of your total physical or mental disability, your legal representative) that you are physically or mentally unable to perform your duties of Chief Operating Officer under this Agreement and that such disability can reasonably be expected to continue for a period of six consecutive months or for shorter periods aggregating 180 days in any 12-month period.

3. Compensation.

3.1. Salary. The Company will pay you, for all services you perform hereunder, an annual salary of \$650,000, or such higher amount as the Compensation Committee of the Board (the "Compensation Committee") may determine, payable in accordance with the Company's payroll schedule applicable to executive officers of the Company.

3.2. Bonus Compensation. In addition to your above-mentioned salary, we will pay you, within 90 days following the end of each fiscal year of the Company during the term of your employment, annual bonus compensation in an amount determined in accordance with the Company's Supplemental Compensation Plan. We agree that for the entire term hereof, you shall be entitled to participate in that plan.

3.3. Employee Benefits. During the term of your employment, you will participate in and receive any benefits to which you are entitled under employee benefit plans which the Company provides for all employees, as well as all benefits which the Company provides, or may at any time in the future provide, for its executive officers.

3.4. Expenses; Car Allowance. During the term of your employment, we will: (a) pay you a car allowance per month of \$1,500, or such higher amount as may be determined by the Compensation Committee; and (b) reimburse you for all expenses incurred by you in the performance of your duties and responsibilities under this Agreement, including, without limitation, entertainment and travel expenses, in accordance with the policies and procedures established by the Compensation Committee.

3.5. Life and Disability Insurance. In addition to the foregoing, we will obtain in your name a life insurance policy providing for a death benefit of \$1,000,000 payable to any beneficiary or beneficiaries named by you, and, at your request, a disability insurance policy providing for monthly payments to you of at least \$12,800 during the period of any disability until the earlier of your attaining age 65 or death. During the term of your employment, we will pay all premiums due on such policies.

3.6. Severance. In the event of the expiration or termination of the term of your employment (other than for Cause, your death or Disability, or your voluntary termination of your employment, whether through resignation, non-renewal or otherwise), we will pay you a lump sum, within 30 days following such expiration or termination, equal to (a) the sum of (i) your then annual salary, (ii) your annual bonus for the then most recently completed fiscal year of the Company, and (iii) the then aggregate annual dollar amount of the payments made or to be made by the Company for purposes of providing you with the benefits set forth in paragraphs 3.3 through 3.5 above, multiplied by (b) the greater of (i) two or (ii) the number of months remaining in the term of this Agreement divided by 12. You shall be under no duty to mitigate damages and the amount paid to you under this paragraph 3.6 shall not be diminished in any way by your earnings or income from any other sources.

3.7. Stock Options. Contemporaneously with the execution of this Agreement, the Company has acknowledged and approved the Agreement between you and Leonard Riggio regarding his grant of options to you of certain rights with respect to his options to purchase 2,000,000 shares of Common Stock of the Company.

3.8. Change of Control Payments. (a) If at any time during the term of this Agreement there is a Change of Control and (i) your employment is terminated by the Company for any reason (other than for Cause) or (ii) you voluntarily terminate your employment for Good Cause, in either case within the greater of two years following the Change of Control or the remaining term of this Agreement, the Company shall pay to you the following amount: (A) the sum of (x) your then annual salary, (y) your then most recent annual bonus, and (z) the then aggregate annual dollar amount of the payments made or to be made by the Company for purposes of providing you with the benefits set forth in paragraphs 3.3 through 3.6 above, multiplied by (B) the greater of (x) three or (y) the number of months remaining in the term of this Agreement divided by 12; provided that the maximum amount payable pursuant to this Section 3.8 shall be the maximum amount payable to the Executive without triggering an excise tax under Section 280G of the Internal Revenue Code of 1986, as amended, or any successor provision thereto. The amount due under this Section 3.8 shall be paid to you in one lump sum within 30 days after the date your employment terminates. Subject to the Section 280G limitation referred to above, to the extent that you are not fully vested in any retirement benefits from any pension, profit-sharing or other retirement plan or program maintained by the Company, the Company shall pay directly to you the difference between the amounts which would have been paid to you had you been fully vested on the date that your employment terminates and the amounts actually paid or payable to you pursuant to such plans or programs. The amounts payable to you under this Section 3.8 shall be in lieu of any amounts payable to you under Section 3.6 above.

(b) As used herein, "Change of Control" shall mean the occurrence of one or more of the following events:

(i) after the date hereof, any person, entity or "group" as identified in Sections 13(d)(3) or 14(d)(2) of the Securities Exchange Act of 1934 (the "1934 Act"), other than you or any of your affiliates or Leonard Riggio or any of his heirs or affiliates, becomes a beneficial owner (as such term is defined in Rule 13d-3 under the 1934 Act) directly or indirectly of securities representing 40% or more of the total number of votes that may be cast for the election of directors of the Company; or

(ii) within two years after a merger, consolidation, liquidation or sale of assets involving the Company, or a contested election of a Company director, or any combination of the foregoing, the individuals who were directors of the Company immediately prior thereto shall cease to constitute a majority of the Board; or

(iii) within two years after a tender offer or exchange offer for voting securities of the Company, the individuals who were directors of the Company immediately prior thereto shall cease to constitute a majority of the Board.

(c) As used herein, "Good Cause" shall mean the occurrence of one or more of the following events within two years after a Change of Control:

(i) there shall have been a material modification of your duties, title or direct reports;

(ii) there shall have been a material reduction in the compensation and benefits you receive from the Company; or

(iii) the principal executive offices of the Company shall be relocated to a location outside of the New York City metropolitan area.

4. Non-Competition.

4.1. **Covenant.** You agree that so long as you are employed by the Company and for a period of two years thereafter, you will not directly or indirectly, either as principal, agent, stockholder, employee or in any other capacity, engage in or have a financial interest in any business that is competitive with the businesses operated by the Company or any of its subsidiaries. The foregoing provision shall cease to apply after: (i) you voluntarily terminate your employment for Good Cause within two years following a Change of Control; or (ii) your employment terminates involuntarily, other than for Cause prior to a Change of Control.

4.2. **Ownership of Other Securities.** Nothing in paragraph 4.1 shall be construed as denying you the right to own securities of any corporation listed on a national securities exchange or quoted in the NASDAQ System to the extent of an aggregate of 5% of the outstanding shares of such securities.

4.3. **Reasonableness.** You acknowledge that the foregoing limitations are reasonable and properly required by the Company and that in the event that any such limitations are found to be unreasonable by a court of competent jurisdiction, you will submit to the reduction of such limitations as the court shall find reasonable.

4.4. **Severability.** If any of the restrictions in paragraph 4.1 should for any reason whatsoever be declared invalid by a court of competent jurisdiction, the validity or enforceability of the remainder of this Agreement will not be adversely affected thereby.

4.5. **Equitable Relief.** You acknowledge that your services to the Company are of a unique character which give them a special value to the Company. You further recognize that any violation of the restrictions in paragraph 4.1 may give rise to losses or damages for which the Company cannot be reasonably or adequately compensated in an action at law and that such violation may result in irreparable and continuing harm to the Company. Accordingly, you agree that, in addition to any other remedy which the Company may have at law or in equity, the Company shall be entitled to injunctive relief to restrain any violation by you of the restrictions in paragraph 4.1.

5. **Indemnification.** You shall be indemnified by the Company, as an officer and director of the Company and its affiliates, against all actions, suits, claims, legal proceedings and the like to the fullest extent permitted by law, including advancement of expenses, partial indemnification, indemnification following the termination of this Agreement, indemnification of your estate and similar matters.

6. Miscellaneous.

6.1. **Entire Agreement.** This Agreement constitutes the entire agreement between you and the Company with respect to the terms and conditions of your employment by the Company and supersedes all prior agreements, understandings and

arrangements, oral or written, between you and the Company with respect to your employment by the Company, including the agreement between us dated as of January 1, 2000.

6.2. **Binding Effect; Benefits.** This Agreement shall inure to the benefit of and shall be binding upon you and the Company and our respective heirs, legal representatives, successors and assigns.

6.3. **Amendments and Waivers.** This Agreement may not be amended or modified except by an instrument or instruments in writing signed by the party against whom enforcement of any such modification or amendment is sought. Either party may, by an instrument in writing, waive compliance by the other party with any term or provision of this Agreement to be performed or complied with by such other party.

6.4. **Assignment.** Neither this Agreement nor any rights or obligations which either party may have by reason of this Agreement shall be assignable by either party without the prior written consent of the other party.

6.5. **Litigation Expenses.** The Company will pay any actual expenses for reasonable attorneys' fees and disbursements incurred by you, or your personal representative, in seeking to obtain or enforce any right or benefit under this Agreement, if you or your representative is the prevailing party.

6.6. **No Mitigation.** In the event of termination of this Agreement by you as a result of the breach by the Company of any of its obligations hereunder, or in the event of the termination of your employment by the Company in breach of this Agreement, you shall not be required to seek other employment in order to mitigate damages hereunder.

6.7. **Notices.** Any notice which may or must be given under this Agreement shall be in writing and shall be personally delivered or sent by certified or registered mail, postage prepaid, or reputable overnight courier, addressed to you or the Company, as the case may be, at the address set forth on the first page hereof, or to such other address as you or the Company, as the case may be, may designate in writing in accordance with the provisions of this paragraph.

6.8. **Section and Other Headings.** The section and other headings contained in this Agreement are for reference purposes only and are not deemed to be a part of this Agreement or to affect the meaning and interpretation of this Agreement.

6.9. **Governing Law.** This Agreement shall be construed (both as to validity and performance) and enforced in accordance with and governed by the laws of the State of New York applicable to agreements made and to be performed wholly within the State of New York.

6.10. **Survival of Rights and Obligations.** All rights and obligations of you and the Company arising during the term of this Agreement shall continue to have full force and effect after the termination of this Agreement unless otherwise provided herein.

If the foregoing accurately reflects our agreement, kindly sign and return to us the enclosed duplicate copy of this letter.

Very truly yours,

BARNES & NOBLE, INC.

By: /s/Lawrence S. Zilavy

Name: Lawrence S. Zilavy
Title: Chief Financial Officer

ACCEPTED AND AGREED TO:

/s/ Stephen Riggio

Stephen Riggio

Exhibit 13.1
SELECTED CONSOLIDATED FINANCIAL DATA

The selected consolidated financial data of Barnes & Noble, Inc. and its subsidiaries (collectively, the Company) set forth on the following pages should be read in conjunction with the consolidated financial statements and notes included elsewhere in this report. The Company's fiscal year is comprised of 52 or 53 weeks, ending on the Saturday closest to the last day of January. The Statement of Operations Data for the 52 weeks ended February 1, 2003 (fiscal 2002), 52 weeks ended February 2, 2002 (fiscal 2001) and 53 weeks ended February 3, 2001 (fiscal 2000) and the Balance Sheet Data as of February 1, 2003 and February 2, 2002 are derived from, and are qualified by reference to, audited consolidated financial statements which are included elsewhere in this report. The Statement of Operations Data for the 52 weeks ended January 29, 2000 (fiscal 1999) and the 52 weeks ended January 30, 1999 (fiscal 1998) and the Balance Sheet Data as of February 3, 2001, January 29, 2000 and January 30, 1999 are derived from audited consolidated financial statements not included in this report. Certain prior-period amounts have been reclassified for comparative purposes.

Fiscal Year (Thousands of dollars, except per share data)	2002	2001	2000(1)(2)	1999(3)	1998
STATEMENT OF OPERATIONS DATA:					
Sales					
Barnes & Noble stores(4)	\$3,574,909	3,359,464	3,169,591	2,821,549	2,515,352
B. Dalton stores(5)	260,024	310,303	372,230	426,018	468,414
Other	81,611	79,225	76,419	14,728	21,842
Total bookstore sales	3,916,544	3,748,992	3,618,240	3,262,295	3,005,608
GameStop stores(6)	1,352,791	1,121,398	757,564	223,748	—
Total sales	5,269,335	4,870,390	4,375,804	3,486,043	3,005,608
Cost of sales and occupancy	3,855,842	3,560,038	3,169,724	2,483,729	2,142,717
Gross profit	1,413,493	1,310,352	1,206,080	1,002,314	862,891
Selling and administrative expenses	965,135	904,280	812,992	651,099	580,609
Legal settlement expense(7)	—	4,500	—	—	—
Depreciation and amortization	148,691	147,826	144,760	112,304	88,345
Pre-opening expenses	10,227	7,959	7,669	6,801	8,795
Impairment charge(8)	25,328	—	106,833	—	—
Operating profit	264,112	245,787	133,826	232,110	185,142
Interest expense, net and amortization of deferred financing fees(9)	(21,506)	(36,334)	(53,541)	(23,765)	(24,412)
Equity in net loss of Barnes & Noble.com(10)	(26,795)	(88,378)	(103,936)	(42,047)	(71,334)
Gain on formation of Barnes & Noble.com(11)	—	—	—	25,000	63,759
Other income (expense)(12)	(16,498)	(11,730)	(9,346)	27,337	3,414
Earnings (loss) before taxes, cumulative effect of a change in accounting principle and minority interest	199,313	109,345	(32,997)	218,635	156,569
Income taxes	80,223	45,378	18,969	89,637	64,193
Earnings (loss) before cumulative effect of a change in accounting principle and minority interest	119,090	63,967	(51,966)	128,998	92,376
Cumulative effect of a change in accounting principle	—	—	—	(4,500)	—
Earnings (loss) before minority interest	119,090	63,967	(51,966)	124,498	92,376
Minority interest (13)	(19,142)	—	—	—	—
Net earnings (loss)	\$ 99,948	63,967	(51,966)	124,498	92,376
Earnings (loss) per common share					
Basic					
Earnings (loss) before cumulative effect of a change in accounting principle	\$ 1.51	0.96	(0.81)	1.87	1.35
Cumulative effect of a change in accounting principle	\$ —	—	—	(0.07)	—
Net earnings (loss)	\$ 1.51	0.96	(0.81)	1.80	1.35
Diluted					

Fiscal Year (Thousands of dollars, except per share data)	2002	2001	2000(1)(2)	1999(3)	1998
Earnings (loss) before cumulative effect of a change in accounting principle	\$ 1.39	0.94	(0.81)	1.81	1.29
Cumulative effect of a change in accounting principle	\$ —	—	—	(0.06)	—
Net earnings (loss)	\$ 1.39	0.94	(0.81)	1.75	1.29

Weighted average common shares outstanding					
Basic	66,362,000	66,393,000	64,341,000	69,005,000	68,435,000
Diluted	77,680,000	77,839,000	64,341,000	71,354,000	71,677,000

OTHER OPERATING DATA:

Number of stores					
Barnes & Noble stores(4)	628	591	569	542	520
B. Dalton stores(5)	258	305	339	400	489
GameStop stores(6)	1,231	1,038	978	526	—
Total	2,117	1,934	1,886	1,468	1,009

Comparable store sales increase (decrease)(14)					
Barnes & Noble stores(4)	0.0%	2.7%	4.9%	6.1%	5.0%
B. Dalton stores(5)	(6.4)	(3.7)	(1.7)	0.1	(1.4)
GameStop stores(6)	11.4	32.0	(6.7)	12.5	—

Capital expenditures	\$ 179,545	168,833	134,292	146,294	141,378
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BALANCE SHEET DATA:

Working capital	\$ 655,420	450,766	520,178	318,668	315,989
Total assets	\$ 2,995,427	2,623,220	2,557,476	2,413,791	1,807,597
Long-term debt	\$ 300,000	449,000	666,900	431,600	249,100
Shareholders' equity	\$ 1,027,790	888,110	777,677	846,360	678,789

- (1) Fiscal 2000 includes the results of operations of Funco, Inc. from June 14, 2000, the date of acquisition.
- (2) In fiscal 2000, the Company acquired a controlling interest in Calendar Club L.L.C. (Calendar Club). The Company's consolidated statement of operations includes the results of operations of Calendar Club. Prior to fiscal 2000, the Company included its equity in the results of operations of Calendar Club as a component of other income (expense).
- (3) Fiscal 1999 includes the results of operations of Babbage's Etc. LLC from October 28, 1999, the date of acquisition.
- (4) Also includes Bookstop and Bookstar stores.
- (5) Also includes Doubleday Book Shops, Scribner's Bookstores and smaller format bookstores operated under the Barnes & Noble trade name representing the Company's original retail strategy.
- (6) Also includes FuncoLand stores, Software Etc. stores and Babbage's stores.
- (7) Represents legal and settlement costs associated with the lawsuit brought by the American Booksellers Association.

- (8) In fiscal 2002, the Company recorded a non-cash charge to operating earnings to write down its investments in Gemstar-TV Guide International, Inc. (Gemstar) and Indigo Books & Music Inc. (Indigo) to their fair market value. In fiscal 2000, the Company recorded a non-cash charge to adjust the carrying value of certain assets, primarily goodwill relating to the purchase of B. Dalton and other mall-bookstore assets.
- (9) Interest expense for fiscal 2002, 2001, 2000, 1999 and 1998 is net of interest income of \$3,499, \$1,319, \$939, \$1,449 and \$976, respectively.
- (10) On November 12, 1998, the Company and Bertelsmann AG (Bertelsmann) completed the formation of a limited liability company to operate the online retail bookselling operations of the Company's wholly owned subsidiary, barnesandnoble.com inc., which had begun operations in fiscal 1997. As a result of the formation of barnesandnoble.com llc (Barnes & Noble.com), the Company began accounting for its interest in Barnes & Noble.com under the equity method of accounting as of the beginning of fiscal 1998. Fiscal 1998 reflects a 100 percent equity interest in Barnes & Noble.com for the first three quarters ended October 31, 1998 (also the effective date of the limited liability company agreement), and a 50 percent equity interest beginning on November 1, 1998 through the end of the fiscal year. As a result of the initial public offering (IPO) for the Barnes & Noble.com business on May 25, 1999, the Company and Bertelsmann each retained a 40 percent interest in Barnes & Noble.com. From the date of the IPO through the end of fiscal 2002, the Company's ownership interest has varied from 40 percent to 36 percent.
- (11) As a result of the formation of the limited liability company Barnes & Noble.com, the Company recognized a pre-tax gain during fiscal 1998 in the amount of \$126,435, of which \$63,759 has been recognized in earnings based on the \$75,000 received directly from Bertelsmann and \$62,676 (\$36,351 after taxes) has been reflected in additional paid-in capital based on the Company's share of the incremental equity of the joint venture resulting from the \$150,000 Bertelsmann contribution. As a result of the Barnes & Noble.com IPO, the Company recorded an increase in additional paid-in capital of \$200,272 (\$116,158 after taxes) representing the Company's incremental share in the equity in Barnes & Noble.com. In addition, the Company recognized a pre-tax gain of \$25,000 in fiscal 1999 as a result of cash received in connection with the joint venture agreement with Bertelsmann.
- (12) In fiscal 2002, the Company determined that a decrease in value in certain of its equity investments occurred which was other than temporary. As a result, other expense of \$16,498 in fiscal 2002 includes the recognition of losses of \$11,485 in excess of what

would otherwise have been recognized by application of the equity method in accordance with Accounting Principles Board Opinion No. 18, "The Equity Method of Accounting for Investments in Common Stock." The \$16,498 loss in other expense was primarily comprised of \$8,489 attributable to iUniverse.com, \$5,081 attributable to *BOOK®* magazine and \$2,351 attributable to enews, inc. Included in other expense for fiscal 2001 is \$3,985 in equity losses in iUniverse.com, \$2,500 in equity losses in *BOOK®* magazine and \$5,581 in equity losses in enews, inc. Included in other expense in fiscal 2000 are losses of \$9,730 from the Company's equity investments. Included in other income in fiscal 1999 are pre-tax gains of \$22,356 and \$10,975 recognized in connection with the Company's investments in Gemstar and Indigo, respectively, as well as a charge of \$5,000 attributable to the termination of the Ingram Book Group acquisition and losses from equity investments of \$994.

- (13) During fiscal 2002, the Company completed an IPO for its GameStop subsidiary. The Company retained an approximate 63 percent interest in GameStop.
- (14) Comparable store sales increase (decrease) is calculated on a 52-week basis, and includes sales of stores that have been open for 15 months for Barnes & Noble stores (due to the high sales volume associated with grand openings) and 12 months for B. Dalton and GameStop stores.

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

The Company's fiscal year is comprised of 52 or 53 weeks, ending on the Saturday closest to the last day of January. As used in this section, "fiscal 2003" represents the 52 weeks ending January 31, 2004, "fiscal 2002" represents the 52 weeks ended February 1, 2003, "fiscal 2001" represents the 52 weeks ended February 2, 2002 and "fiscal 2000" represents the 53 weeks ended February 3, 2001.

General

Barnes & Noble, Inc. (Barnes & Noble or the Company), the nation's largest bookseller¹, as of February 1, 2003 operates 886 bookstores and 1,231 video-game and entertainment-software stores. Of the 886 bookstores, 628 operate under the Barnes & Noble Booksellers, Bookstop and Bookstar trade names (47 of which were opened in fiscal 2002) and 258 operate under the B. Dalton Bookseller, Doubleday Book Shops and Scribner's Bookstore trade names. Through its approximate 38 percent interest in barnesandnoble.com llc (Barnes & Noble.com), the Company is one of the largest sellers of books on the Internet. The Company, through its approximate 63 percent interest in GameStop Corp., is the nation's largest video-game and PC-entertainment software specialty retailer, operating 1,231 video-game and entertainment-software stores under the GameStop, Babbage's, Software Etc. and FuncoLand trade names, a Web site, gamestop.com, and *Game Informer*, one of the largest multi-platform video-game magazines, with circulation of over one million subscribers. The Company employed approximately 50,000 full- and part-time employees as of February 1, 2003.

Barnes & Noble is the nation's largest operator of bookstores¹ with 628 Barnes & Noble bookstores located in 49 states and the District of Columbia as of February 1, 2003. With more than 35 years of bookselling experience, management has a strong sense of customers' changing needs and the Company leads book retailing with a "community store" concept. Barnes & Noble's typical bookstore offers a comprehensive title base, a café, a children's section, a music department, a magazine section and a calendar of ongoing events, including author appearances and children's activities, that make each Barnes & Noble bookstore an active part of its community.

Barnes & Noble bookstores range in size from 10,000 to 60,000 square feet depending upon market size, and each store features an authoritative selection of books, ranging from 60,000 to 200,000 titles. The comprehensive title selection is diverse and reflects local interests. In addition, Barnes & Noble emphasizes books published by small and independent publishers and university presses. Bestsellers represent only three percent of Barnes & Noble bookstore sales. Complementing this extensive on-site selection, all Barnes & Noble bookstores provide customers with access to the millions of books available to online shoppers while offering an option to have the book sent to the store or shipped directly to the customer. All Barnes & Noble bookstores are equipped with the BookMaster in-store operating system, which enhances the Company's merchandise-replenishment system, resulting in high in-stock positions and productivity at the store level through efficiencies in receiving, cashiering and returns processing.

During fiscal 2002, the Company added 1.0 million square feet to the Barnes & Noble bookstore base, bringing the total square footage to 15.2 million square feet, a seven percent increase over the prior year. Barnes & Noble bookstores contributed approximately 91 percent of the Company's total bookstore sales in fiscal 2002. The Company plans to open between 35 and 40 Barnes & Noble bookstores in fiscal 2003, which are expected to average 25,000 square feet in size.

At the end of fiscal 2002, the Company operated 258 B. Dalton bookstores in 44 states and the District of Columbia. B. Dalton bookstores employ merchandising strategies that target the mainstream

¹ Based upon sales reported in trade publications and public filings.

consumer book market, offering a wide range of bestsellers and general-interest titles. Most B. Dalton bookstores range in size from 2,000 to 6,000 square feet, and while they are appropriate to the size of adjacent mall tenants, the opening of book superstores in nearby locations continues to have a significant adverse impact on B. Dalton bookstores.

The Company is continuing to execute a strategy to maximize returns from its B. Dalton bookstores in response to declining sales attributable primarily to book superstore competition. Part of the Company's strategy has been to close underperforming stores, which has resulted in the closing of between 35 and 90 B. Dalton bookstores per year since 1989.

The Company currently has a 38 percent ownership interest in Barnes & Noble.com, a leading internet-based retailer of books, music, DVD/video and online courses. Since opening its online store (www.bn.com) in March 1997, Barnes & Noble.com has attracted more than 13.6 million customers in 232 countries. Barnes & Noble.com's bookstore includes the largest in-stock selection of in-print book titles with access to approximately one million titles for immediate delivery, supplemented by more than 30 million listings from its nationwide network of out-of-print, rare and used book dealers. Barnes & Noble.com offers its customers fast delivery, easy and secure ordering and rich editorial content.

According to Jupiter Media Metrix, in December 2002, Barnes & Noble.com's Web site was the ninth most-trafficked shopping site and was among the top 50 largest Web properties on the Internet. Co-marketing agreements with major Web portals such as AOL, Yahoo! and MSN as well as content sites have extended Barnes & Noble.com's brand and increased consumer exposure to its site. Barnes & Noble.com has also established a network of remote virtual storefronts across the Internet by creating direct links with more than 176,000 affiliate Web sites.

Barnes & Noble further differentiates its product offerings from those of its competitors by publishing books under its own imprints. The Company, through its January 2003 acquisition of Sterling Publishing Co., Inc. (Sterling), is one of the top 25 publishers in the nation and the industry's leading publisher of how-to books. Sterling has an active list of more than 4,500 owned and distributed titles, and publishes and distributes more than 1,000 new titles annually. As a leading publisher of how-to books, Sterling has strength in art technique, gardening, cooking, health, crafts, puzzle and game, woodworking and house and home. With the addition of the Sterling titles, the Company has publishing or distribution rights to nearly 10,000 titles and offers customers high quality books at exceptional values, while generating attractive gross margins.

The Company acquired Babbage's Etc. and Funco, Inc. in October 1999 and June 2000, respectively. Through a corporate restructuring, Babbage's Etc. became a wholly owned subsidiary of Funco, Inc. and the name of Funco, Inc. was changed to GameStop, Inc. In February 2002, the Company completed an initial public offering for its GameStop subsidiary. The Company retained an approximate 63 percent interest in GameStop. GameStop is the nation's largest video-game and PC-entertainment software specialty retailer, operating 1,231 video-game and entertainment-software stores located in 49 states, Puerto Rico and Guam. The video-game and entertainment-software stores range in size from 500 to 5,000 square feet (averaging 1,500 square feet) depending upon market demographics. Stores feature video-game hardware and software, PC-entertainment software and a multitude of accessories. GameStop operates stores under the GameStop, Babbage's, Software Etc. and FuncoLand trade names, a Web site, gamestop.com, and *Game Informer* magazine (collectively, GameStop or Video Game & Entertainment Software).

Critical Accounting Policies

Management's Discussion and Analysis of Financial Condition and Results of Operations

discusses the Company's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements require management to make estimates and assumptions in certain circumstances that affect amounts reported in the accompanying consolidated financial statements and related footnotes. In preparing these financial statements, management has made its best estimates and judgments of certain amounts included in the financial statements, giving due consideration to materiality. The Company does not believe there is a great likelihood that materially different amounts would be reported related to the accounting policies described below. However, application of these accounting policies involves the exercise of judgment and use of assumptions as to future uncertainties and, as a result, actual results could differ from these estimates.

Impairment of Long-Lived Assets and Goodwill

The Company's long-lived assets include property and equipment and goodwill. At February 1, 2003, the Company had \$622.3 million of property and equipment, net of accumulated depreciation, and \$438.6 million of goodwill, net of amortization, accounting for approximately 35.4% of the Company's total assets.

The Company periodically reviews its property and equipment under the newly issued accounting pronouncement Statement of Financial Accounting Standards (SFAS) No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable or their depreciation periods should be accelerated. Factors that the Company considers important which could trigger a review include the following:

- Significant changes in the manner of use of the assets
- Significant changes in the strategy of the overall business
- Significant underperformance relative to expected historical or projected future operating results

Recoverability is assessed based on several factors, including management's intentions with respect to its stores and those stores' projected undiscounted cash flows. Assumptions underlying such projected cash flows include historical experience of stores, competitive environment, purchasing trends and projected demographics in the areas.

If it is determined that the carrying value of long-lived assets may not be recoverable, the Company measures impairment based on the present values of the projected cash flows using a discount rate determined by the Company's management to be commensurate with the risk involved.

In fiscal 2002, the Company adopted SFAS No. 142, "Goodwill and Other Intangible Assets". SFAS No. 142 requires that purchased goodwill and certain indefinite-lived intangibles no longer be amortized, but instead be tested for impairment at least annually. As a result of adopting SFAS No. 142, the Company ceased amortization of goodwill beginning February 3, 2002. Prior to the adoption of SFAS No. 142, the Company amortized goodwill on a straight-line basis over 30 to 40 years.

SFAS No. 142 prescribes a two-step process for impairment testing of goodwill. The first step of this test, used to identify potential impairment, compares the fair value of a reporting unit with its carrying amount, including goodwill. The second step (if necessary) measures the amount of the impairment. Using the guidance in SFAS No. 142, the Company has determined that it has two reporting units, bookstores and video-game and entertainment-software stores. The Company completed its initial impairment test on the goodwill in the second quarter of fiscal 2002 and its annual

impairment test in November 2002. Both tests indicated that the fair value of the reporting units exceeded that reporting unit's carrying amount; accordingly, the second testing phase was not necessary. The Company has noted no subsequent indicators that would require testing goodwill for impairment.

Closed Store Expenses

Upon a formal decision to close or relocate a store, the Company charges unrecoverable costs to expense. Such costs include the net book value of abandoned fixtures and leasehold improvements and, when a store is closed, a provision for future lease obligations, net of expected sublease recoveries. Costs associated with store closings of \$10.1 million, \$9.8 million and \$5.0 million during fiscal 2002, fiscal 2001 and fiscal 2000, respectively, are included in selling and administrative expenses in the accompanying consolidated statements of operations.

Results of Operations

The Company's sales, operating profit, comparable store sales, store openings, store closings, number of stores open and square feet of selling space at year end are set forth below:

Fiscal Year (Thousands of dollars)	2002	2001	2000
Sales			
Bookstores	\$3,916,544	3,748,992	3,618,240
Video Game & Entertainment Software stores	1,352,791	1,121,398	757,564
Total	<u>\$5,269,335</u>	<u>4,870,390</u>	<u>4,375,804</u>
Operating Profit			
Bookstores (1)	\$ 177,041	211,700	127,812
Video Game & Entertainment Software stores	87,071	34,087	6,014
Total	<u>\$ 264,112</u>	<u>245,787</u>	<u>133,826</u>
Comparable Store Sales Increase (Decrease) (2)			
Barnes & Noble stores	0.0%	2.7%	4.9%
B. Dalton stores	(6.4)	(3.7)	(1.7)
GameStop stores	11.4	32.0	(6.7)
Stores Opened			
Barnes & Noble stores	47	40	32
B. Dalton stores	—	1	—
GameStop stores	210	74	65
Total	<u>257</u>	<u>115</u>	<u>97</u>
Stores Closed			
Barnes & Noble stores	10	18	5
B. Dalton stores	47	35	61
GameStop stores	17	14	17
Total	<u>74</u>	<u>67</u>	<u>83</u>
Number of Stores Open at Year End			
Barnes & Noble stores	628	591	569
B. Dalton stores	258	305	339
GameStop stores	1,231	1,038	978
Total	<u>2,117</u>	<u>1,934</u>	<u>1,886</u>
Square Feet of Selling Space at Year End (in millions)			
Barnes & Noble stores	15.2	14.2	13.4
B. Dalton stores	1.0	1.2	1.4
GameStop stores	1.9	1.6	1.5
Total	<u>18.1</u>	<u>17.0</u>	<u>16.3</u>

(1) Fiscal 2002 operating profit is net of a non-cash impairment charge

of \$25,328. Fiscal 2001 operating profit is net of legal and settlement expenses of \$4,500. Fiscal 2000 operating profit is net of a non-cash impairment charge of \$106,833.

- (2) Comparable store sales for Barnes & Noble stores are determined using stores open at least 15 months, due to the high sales volume associated with grand openings. Comparable store sales for B. Dalton and GameStop stores are determined using stores open at least 12 months.

The following table sets forth, for the periods indicated, the percentage relationship that certain items bear to total sales of the Company:

Fiscal Year	2002	2001	2000
Sales	100.0%	100.0%	100.0%
Cost of sales and occupancy	73.2	73.1	72.4
Gross margin	26.8	26.9	27.6
Selling and administrative expenses	18.3	18.6	18.6
Legal settlement expense	—	0.1	—
Depreciation and amortization	2.8	3.0	3.3
Pre-opening expenses	0.2	0.2	0.2
Impairment charge	0.5	—	2.4
Operating margin	5.0	5.0	3.1
Interest expense, net and amortization of deferred financing fees	(0.4)	(0.8)	(1.2)
Equity in net loss of Barnes & Noble.com	(0.5)	(1.8)	(2.4)
Other expense	(0.3)	(0.2)	(0.2)
Earnings (loss) before income taxes and minority interest	3.8	2.2	(0.7)
Income taxes	1.5	0.9	0.4
Income before minority interest	2.3	1.3	(1.1)
Minority interest	(0.4)	—	—
Net earnings (loss)	1.9%	1.3%	(1.1)%

52 Weeks Ended February 1, 2003 Compared with 52 Weeks Ended February 2, 2002

Sales

The Company's sales increased \$398.9 million or 8.2% during fiscal 2002 to \$5.269 billion from \$4.870 billion during fiscal 2001. Contributing to this improvement was an increase of \$231.4 million from Video Game & Entertainment Software store sales. Fiscal 2002 sales from Barnes & Noble bookstores, which contributed 67.8% of total sales or 91.3% of total bookstore sales, increased 6.4% to \$3.575 billion from \$3.359 billion in fiscal 2001.

The increase in bookstore sales was primarily attributable to the 47 new Barnes & Noble stores opened during fiscal 2002. This increase was partially offset by declining sales of B. Dalton, due to 47 store closings and a comparable store sales decline of (6.4%) in fiscal 2002.

GameStop sales during fiscal 2002 increased to \$1.353 billion from \$1.121 billion during fiscal 2001. This increase in sales was primarily attributable to the 11.4% growth in GameStop comparable store sales and sales from the 210 new GameStop stores opened during fiscal 2002.

Cost of Sales and Occupancy

The Company's cost of sales and occupancy includes costs such as rental expense, common area maintenance, merchant association dues and lease-required advertising.

Cost of sales and occupancy increased \$295.8 million, or 8.3%, to \$3.856 billion in fiscal 2002 from \$3.560 billion in fiscal 2001, primarily due to growth in the Video Game & Entertainment Software segment. The Company's gross margin rate decreased slightly to 26.8% in fiscal 2002 from 26.9% in fiscal 2001.

Selling and Administrative Expenses

Selling and administrative expenses increased \$60.8 million, or 6.7%, to \$965.1 million in fiscal 2002 from \$904.3 million in fiscal 2001, primarily due to the increase in bookstore expenses from the opening of 47 Barnes & Noble stores in fiscal 2002 and to the growth in the Video Game & Entertainment Software segment. Selling and administrative expenses decreased to 18.3% of sales in fiscal 2002 from 18.6% in fiscal 2001. This decrease was primarily attributable to the lower selling and administrative expenses, as a percentage of sales in the Video Game & Entertainment Software segment.

Legal Settlement Expense

In fiscal 2001, the Company recorded a pre-tax charge of \$4.5 million in connection with a lawsuit brought by the American Booksellers Association and 26 independent bookstores. The charges included a settlement of \$2.4 million paid to the plaintiffs and approximately \$2.1 million in legal expenses incurred by the Company.

Depreciation and Amortization

Depreciation and amortization increased \$0.9 million, or 0.6%, to \$148.7 million in fiscal 2002 from \$147.8 million in fiscal 2001. The increase was primarily the result of the increase in depreciation related to the 47 new Barnes & Noble bookstores opened during fiscal 2002. This increase was partially offset by the result of the implementation of SFAS No. 142 in fiscal 2002, whereby goodwill is no longer amortized but is reviewed for impairment at least annually.

Pre-Opening Expenses

Pre-opening expenses increased in fiscal 2002 to \$10.2 million from \$8.0 million in fiscal 2001. The increase in pre-opening expenses was primarily the result of opening 47 new Barnes & Noble bookstores and 210 new GameStop stores during fiscal 2002, compared with 40 new Barnes & Noble bookstores and 74 new GameStop stores during fiscal 2001.

Impairment Charge

During the first quarter of fiscal 2002, the Company deemed the decline in value in its available-for-sale securities in Gemstar-TV Guide International, Inc. (Gemstar) and Indigo Books & Music Inc. (Indigo) to be other than temporary. The investments had been carried at fair market value with unrealized gains and losses included in shareholders' equity. Events such as Gemstar's largest shareholder taking an impairment charge for its investment, the precipitous decline in the stock price subsequent to the abrupt resignation of one of its senior executives, the questioning of aggressive revenue recognition policies and the filing of a class action lawsuit against Gemstar, were among the items which led to management's decision to record an impairment for its investment in Gemstar of nearly \$24.0 million (before taxes). The Company's decision to record an impairment charge for its investment in Indigo was based on a review of Indigo's financial condition and historical share trading data. As a result of these decisions, the Company recorded a non-cash impairment charge to operating earnings of \$25.3

million (\$14.9 million after taxes) to reclassify the accumulated unrealized losses and to write down the investments to their current fair market value at the close of business on May 4, 2002. The investment in Gemstar was sold in the second quarter of fiscal 2002.

Operating Profit

Operating profit increased to \$264.1 million in fiscal 2002 from \$245.8 million in fiscal 2001. Operating profit increased to \$289.4 million, before the effect of the \$25.3 million impairment charge during fiscal 2002, from \$250.3 million, before the effect of the \$4.5 million legal settlement expense during fiscal 2001. Bookstore operating profit decreased 6.4% to \$202.4 million, before the effect of the \$25.3 million impairment charge from \$216.2 million, before the effect of the \$4.5 million legal settlement expense, primarily attributable to lower comparable store sales. Bookstore operating margin decreased to 5.2% of sales during fiscal 2002, before the effect of the impairment charge, from 5.8% of sales during fiscal 2001, before the effect of the legal settlement expense.

Interest Expense, Net and Amortization of Deferred Financing Fees

Interest expense, net of interest income, and amortization of deferred financing fees, decreased \$14.8 million to \$21.5 million in fiscal 2002 from \$36.3 million in fiscal 2001. The decrease was primarily the result of reduced borrowings under the Company's senior credit facility due to the pay down of debt with proceeds from the GameStop IPO.

Equity in Net Loss of Barnes & Noble.com

The Company's share in the net loss of Barnes & Noble.com, based on an approximate 36 percent equity interest, was \$26.8 million and \$88.4 million in fiscal 2002 and fiscal 2001, respectively.

Other Expense, Primarily Losses Attributable to Equity-Method Investments

In fiscal 2002, the Company determined that a decrease in value in certain of its equity investments occurred which was other than temporary. As a result, other expense of \$16.5 million during fiscal 2002 included the recognition of losses of \$11.5 million in excess of what would otherwise have been recognized by application of the equity method in accordance with Accounting Principles Board Opinion No. 18, "The Equity Method of Accounting for Investments in Common Stock." The \$16.5 million loss in other expense was primarily comprised of \$8.5 million attributable to iUniverse.com, \$5.1 million attributable to *BOOK®* magazine and \$2.4 million attributable to enews, inc. Other expense of \$11.7 million in fiscal 2001 was due to \$4.0 million in equity losses in iUniverse.com, \$2.5 million in equity losses in *BOOK®* magazine and \$5.5 million in equity losses in enews, inc., partially offset by a one-time gain of \$0.3 million from the partial sale of Indigo.

Provision for Income Taxes

Barnes & Noble's effective tax rate in fiscal 2002 decreased to 40.25 percent compared with 41.50 percent during fiscal 2001.

Minority Interest

During fiscal 2002, minority interest for GameStop was \$19.1 million based on a 36.5% basic weighted average ownership interest.

Earnings

As a result of the factors discussed above, the Company reported consolidated net earnings of \$99.9 million (or \$1.39 per share) during fiscal 2002 compared with net earnings of \$64.0 million (or \$0.94 per share) during fiscal 2001. Components of diluted earnings per share are as follows:

Fiscal Year	2002	2001
Retail EPS	\$ 1.90	1.70
EPS Impact of Investing Activities		
Share in net losses of Barnes & Noble.com	\$(0.21)	(0.66)
Share of net losses from other investments (including earnings from Calendar Club)	(0.11)	(0.07)
Total Investing Activities	\$(0.32)	(0.73)
Other Adjustments		
Impairment charge	\$(0.19)	—
Legal settlement expense	—	(0.03)
Total Other Adjustments	\$(0.19)	(0.03)
Consolidated EPS	\$ 1.39	0.94

52 Weeks Ended February 2, 2002 Compared with 53 Weeks Ended February 3, 2001

Sales

The Company's sales increased \$494.6 million or 11.3% during fiscal 2001 to \$4.870 billion from \$4.376 billion during fiscal 2000. Contributing to this improvement was an increase of \$363.8 million from Video Game & Entertainment Software store sales. Fiscal 2001 sales from Barnes & Noble bookstores, which contributed 69.0% of total sales or 89.6% of total bookstore sales, increased 6.0% to \$3.359 billion from \$3.170 billion in fiscal 2000.

The increase in bookstore sales was primarily attributable to the 2.7% growth in Barnes & Noble comparable store sales and sales from the 40 new Barnes & Noble stores opened during fiscal 2001. This increase was partially offset by declining sales of B. Dalton, due to 35 store closings and a comparable store sales decline of (3.7%) in fiscal 2001.

GameStop sales during fiscal 2001 increased to \$1.121 billion from \$757.6 million during fiscal 2000. This increase in sales was primarily attributable to the 32.0% growth in the GameStop comparable store sales and sales from the 74 new GameStop stores opened during fiscal 2001. This increase was also attributable to the inclusion of a full year of Funco, Inc. sales in fiscal 2001 compared with sales for

approximately one-half of fiscal 2000.

Cost of Sales and Occupancy

The Company's cost of sales and occupancy includes costs such as rental expense, common area maintenance, merchant association dues and lease-required advertising.

Cost of sales and occupancy increased \$390.3 million, or 12.3%, to \$3.560 billion in fiscal 2001 from \$3.170 billion in fiscal 2000, primarily due to growth in the Video Game & Entertainment Software segment. The Company's gross margin rate decreased to 26.9% in fiscal 2001 from 27.6% in fiscal 2000. This decrease was primarily attributable to the lower gross margins in the Video Game & Entertainment Software segment and slightly lower gross margins in the bookstore segment due to discounts related to the Readers' Advantage™ program.

Selling and Administrative Expenses

Selling and administrative expenses increased \$91.3 million, or 11.2%, to \$904.3 million in fiscal 2001 from \$813.0 million in fiscal 2000, primarily due to growth in the Video Game & Entertainment Software segment and the increase in bookstore expenses from the opening of 40 Barnes & Noble stores in fiscal 2001. Selling and administrative expenses remained unchanged at 18.6% of sales during fiscal 2001 and 2000.

Legal Settlement Expense

In fiscal 2001, the Company recorded a pre-tax charge of \$4.5 million in connection with a lawsuit brought by the American Booksellers Association and 26 independent bookstores. The charges included a settlement of \$2.4 million to be paid to plaintiffs and approximately \$2.1 million in legal expenses incurred by the Company during the first quarter.

Depreciation and Amortization

Depreciation and amortization increased \$3.1 million, or 2.1%, to \$147.8 million in fiscal 2001 from \$144.8 million in fiscal 2000. The increase was primarily the result of the increase in depreciation and amortization in the Video Game & Entertainment Software segment offset by the reduction in depreciable assets in small-format mall bookstores due to the impairment charge recorded in fiscal 2000.

Pre-Opening Expenses

Pre-opening expenses increased in fiscal 2001 to \$8.0 million from \$7.7 million in fiscal 2000. Due to management's expense control efforts, pre-opening expenses increased only slightly while opening 40 Barnes & Noble stores and 74 new GameStop stores in fiscal 2001, compared with 32 new Barnes & Noble stores and 65 new GameStop stores during fiscal 2000.

Operating Profit

Operating profit increased to \$245.8 million in fiscal 2001 from \$133.8 million in fiscal 2000. Operating profit increased \$9.6 million to \$250.3 million, before the effect of the \$4.5 million legal settlement expense during fiscal 2001, from \$240.7 million, before the effect of the \$106.8 million impairment charge during fiscal 2000. Bookstore operating profit decreased 7.9% to \$216.2 million, before the effect of the \$4.5 million legal settlement expense, from \$234.6 million, before the effect of the

\$106.8 million impairment charge, primarily attributable to lower comparable store sales and lower gross margins due to discounts related to the Readers' Advantage™ program. Bookstore operating margin decreased to 5.8% of sales during fiscal 2001, before the effect of the legal settlement expense, from 6.5% of sales during fiscal 2000, before the effect of the impairment charge.

Interest Expense, Net and Amortization of Deferred Financing Fees

Interest expense, net of interest income, and amortization of deferred financing fees, decreased \$17.2 million to \$36.3 million in fiscal 2001 from \$53.5 million in fiscal 2000. The decrease was primarily the result of reduced borrowings due to effective working capital management and lower interest rates on the Company's outstanding debt, partially through the issuance of the Company's convertible subordinated notes sold in March 2001.

Equity in Net Loss of Barnes & Noble.com

In November 2000, Barnes & Noble.com acquired Fatbrain.com, Inc. (Fatbrain), the third largest online bookseller. Barnes & Noble.com issued shares of its common stock to Fatbrain shareholders. As a result of this merger, the Company and Bertelsmann each retained an approximate 36 percent interest in Barnes & Noble.com. Accordingly, the Company's share in the net loss of Barnes & Noble.com is based on an approximate 40 percent equity interest from the beginning of fiscal 2000 through November 2000 and approximately 36 percent thereafter. The Company's equity in the net loss of Barnes & Noble.com for fiscal 2001 and fiscal 2000 was \$88.4 million and \$103.9 million, respectively.

Other Expense

Other expense of \$11.7 million in fiscal 2001 was due to \$4.0 million in equity losses in iUniverse.com, \$2.5 million in equity losses in BOOK® magazine and \$5.5 million in equity losses in enews, inc., partially offset by a one-time gain of \$0.3 million from the partial sale of Indigo. Other expense of \$9.3 million in fiscal 2000 was primarily due to the equity losses of iUniverse.com, partially offset by a one-time gain of \$0.3 million from the partial sale of iUniverse.com.

Provision for Income Taxes

Barnes & Noble's effective tax rate in fiscal 2001 decreased to 41.5 percent compared with (57.5) percent during fiscal 2000. The fiscal 2001 decrease was primarily related to the goodwill write-down associated with the impairment charge, which provided no tax benefit in fiscal 2000.

Earnings (Loss)

As a result of the factors discussed above, the Company reported consolidated net earnings of \$64.0 million (or \$0.94 per share) during fiscal 2001 compared with a net loss of (\$52.0) million (or (\$0.81) per share) during fiscal 2000. Components of diluted earnings per share are as follows:

Fiscal Year	2001	2000
Retail EPS	\$ 1.70	1.69
EPS Impact of Investing Activities		
Share in net losses of Barnes & Noble.com	\$(0.66)	(0.98)
Share of net losses from other investments (including earnings from Calendar Club)	(0.07)	(0.08)
Total Investing Activities	\$(0.73)	(1.06)
Other Adjustments		
Legal settlement expense	\$(0.03)	—
Impairment charge	—	(1.44)
Total Other Adjustments	\$(0.03)	(1.44)
Consolidated EPS	\$ 0.94	(0.81)

Seasonality

The Company's business, like that of many retailers, is seasonal, with the major portion of sales and operating profit realized during the quarter which includes the holiday selling season.

Liquidity and Capital Resources

Working capital requirements are generally at their highest in the Company's fiscal quarter ending on or about January 31 due to the higher payments to vendors for holiday season merchandise purchases. In addition, the Company's sales and merchandise inventory levels will fluctuate from quarter to quarter as a result of the number and timing of new store openings, as well as the amount and timing of sales contributed by new stores.

Cash flows from operating activities, funds available under its revolving credit facility and short-term vendor financing continue to provide the Company with liquidity and capital resources for store expansion, seasonal working capital requirements and capital investments.

In February 2002, the Company completed an initial public offering (IPO) for its GameStop subsidiary, raising \$250.0 million in cash for the Company (which was used to pay down debt) and \$98.0 million in net proceeds for GameStop. The Company has retained an approximate 63 percent interest in GameStop.

Cash Flow

Cash flows provided from operating activities were \$329.0 million, \$457.4 million and \$80.5 million during fiscal 2002, 2001 and 2000, respectively. In fiscal 2002, the decrease in cash flows from operating activities was primarily attributable to a weaker-than-expected holiday season, as well as the increase in inventory due to the Reno distribution center becoming fully operational. In fiscal 2001, the

increase in cash flows from operating activities was primarily attributable to increased accounts payable leverage and improvement in net earnings. In fiscal 2000, the decrease in cash flows from operating activities was primarily attributable to a weaker-than-expected holiday season which resulted in lower net earnings and an increase in standing inventory as well as an increase in prepaid rent due to the fiscal year-end date.

Retail earnings before interest, taxes, depreciation and amortization (EBITDA) increased \$0.9 million or 0.2% to \$393.1 million in fiscal 2002 from \$392.2 million in fiscal 2001. Total debt to retail EBITDA improved to 0.76 times in fiscal 2002 from 1.14 times in fiscal 2001, primarily due to decreased borrowings under the Company's senior credit facility. The reduced debt, which was accomplished during a period of 8.2% sales growth and an 8.6% increase in merchandise inventories, was primarily attributable to the proceeds received from the GameStop IPO. The weighted-average age per square foot of the Company's 628 Barnes & Noble stores was 5.8 years as of February 1, 2003 and is expected to increase to approximately 6.5 years by January 31, 2004. As the Barnes & Noble stores continue to mature, and as the number of new stores opened during the fiscal year decreases as a percentage of the existing store base, the increasing operating profits of Barnes & Noble stores are expected to generate a greater portion of the cash flows required for working capital, including new store inventories, capital expenditures and other initiatives.

Since the fiscal 1999 Barnes & Noble.com Inc. IPO, retail cash flows have been fully available to support the Company's working capital requirements. In the future, the Company may provide additional funding to Barnes & Noble.com. As of February 1, 2003, the Company had an aggregate receivable of \$55.2 million from Barnes & Noble.com related to its supply and service agreements. Barnes & Noble.com had cash, cash equivalents and short-term marketable securities of \$70.1 million as of its year ended December 31, 2002, an amount sufficient to cover this payable due to the Company.

Capital Structure

Strong cash flows from operations and a continued emphasis on working capital management strengthened the Company's balance sheet in fiscal 2002. Shareholders' equity increased 15.7% to \$1.028 billion as of February 1, 2003, from \$888.1 million as of February 2, 2002.

In fiscal 2002, the Company obtained a \$500.0 million three-year senior revolving credit facility (the Facility) with a syndicate of banks led by Fleet National Bank as administrative agent. The Facility, which expires in May 2005, replaced the Company's \$850.0 million senior credit facility. The Facility permits borrowings at various interest-rate options based on the prime rate or London Interbank Offer Rate (LIBOR) plus applicable margin depending upon the level of the Company's fixed charge coverage ratio. The Company's fixed charge coverage is calculated as the ratio of earnings before interest, taxes, depreciation, amortization and rents to interest plus rents. In addition, the Facility requires the Company to pay a commitment fee of 0.25 percent, which fee varies based upon the Company's fixed charge coverage ratio, calculated as a percentage of the unused portion. The Company is required to pay utilization fees of 0.125 percent or 0.25 percent on all outstanding loans under the Facility if the aggregate outstanding loans are greater than 33 percent and 66 percent, respectively, of the aggregate amount of the Facility.

A portion of the Facility, not to exceed \$100.0 million, is available for the issuance of letters of credit. Also, under certain circumstances, the Company may be permitted to increase the size of the Facility to an amount not to exceed \$600.0 million and/or to extend the term of the Facility by one additional year.

The amount outstanding under the Facility has been classified as long-term debt in the

accompanying consolidated balance sheets due to both the Company's intent and ability to maintain principal amounts.

In fiscal 2001, the Company issued \$300.0 million of 5.25 percent convertible subordinated notes due March 15, 2009. The notes are convertible into the Company's common stock at a conversion price of \$32.512 per share.

In fiscal 2000, the Company obtained an additional \$100.0 million senior unsecured seasonal credit facility (seasonal credit facility) with a syndicate of banks led by The Chase Manhattan Bank. The seasonal credit facility, which matured on January 31, 2001, permitted for borrowings at an interest rate based on LIBOR. In addition, the agreement required the Company to pay a commitment fee of 0.375 percent of the unused portion. The seasonal credit facility was guaranteed by all restricted subsidiaries of Barnes & Noble.

Borrowings under the Company's convertible subordinated notes, senior and seasonal credit facilities averaged \$377.3 million, \$689.3 million and \$697.8 million and peaked at \$490.3 million, \$870.0 million and \$918.7 million during fiscal 2002, 2001 and 2000, respectively. The ratio of debt to equity improved significantly to 0.29:1.00 as of February 1, 2003 from 0.51:1.00 as of February 2, 2002, primarily due to decreased borrowings under the Company's senior credit facility.

Interest rate swap agreements are valued based on market quotes obtained from dealers. The estimated fair value of the interest rate swaps liability was \$0.0 million and \$2.3 million at February 1, 2003 and February 2, 2002, respectively. The interest rate swaps are included as a component of other long-term liabilities.

Capital Investment

Capital expenditures totaled \$179.5 million, \$168.8 million and \$134.3 million during fiscal 2002, 2001 and 2000, respectively. Capital expenditures in fiscal 2003, primarily for the opening of between 35 and 40 new Barnes & Noble stores and between 235 and 265 GameStop stores, are expected to be between \$140 million and \$160 million, although commitment to many of such expenditures has not yet been made.

Based on current operating levels and the store expansion planned for the next fiscal year, management believes cash flows generated from operating activities, short-term vendor financing and borrowing capacity under its revolving credit facility will be sufficient to meet the Company's working capital and debt service requirements, and support the development of its short- and long-term strategies for at least the next 12 months.

In fiscal 1999, the Board of Directors authorized a common stock repurchase program for the purchase of up to \$250.0 million of the Company's common shares. As of February 1, 2003, the Company has repurchased 8,502,700 shares at a cost of approximately \$181.4 million under this program. The repurchased shares are held in treasury.

In fiscal 2002, the Company announced its intent to purchase up to \$10.0 million of Barnes & Noble.com Class A Common Stock in the open market or through privately negotiated transactions. As of February 1, 2003, the Company purchased approximately 1.7 million shares of Barnes & Noble.com Class A Common Stock for \$1.9 million.

Certain Relationships and Related Transactions

The Company believes that the transactions and agreements discussed below (including renewals of any existing agreements) between the Company and its affiliates are at least as favorable to the Company as could be obtained from unaffiliated parties. The Board of Directors and the Audit Committee are designated to approve in advance any new proposed transaction or agreement with affiliates and will utilize procedures in evaluating the terms and provisions of such proposed transaction or agreement as are appropriate in light of the fiduciary duties of directors under Delaware law.

The Company leases space for its executive offices in properties in which Leonard Riggio, Chairman of the Board and principal stockholder of Barnes & Noble, has a minority interest. The space was rented at an aggregate annual rent including real estate taxes of approximately \$4.0 million, \$4.0 million and \$3.4 million in fiscal years 2002, 2001 and 2000, respectively. Rent per square foot is approximately \$28.00, which is below market.

The Company leases a 75,000-square-foot office/warehouse from a partnership in which Leonard Riggio has a 50 percent interest, pursuant to a lease expiring in 2023. Pursuant to such lease, the Company paid \$0.8 million, \$0.5 million and \$0.6 million in fiscal years 2002, 2001 and 2000, respectively.

The Company leases retail space in a building in which Barnes & Noble College Bookstores, Inc. (B&N College), a company owned by Leonard Riggio, subleases space for its executive offices from the Company. Occupancy costs allocated by the Company to B&N College for this space totaled \$0.8 million, \$0.7 million and \$0.7 million for fiscal years 2002, 2001 and 2000, respectively. The amount paid by B&N College to the Company approximates the cost per square foot paid by the Company to its unaffiliated third-party landlord.

The Company subleased warehouse space from Barnes & Noble.com in Reno, Nevada. The Company paid Barnes & Noble.com \$0.3 million, \$1.8 million and \$1.4 million for such subleased space during fiscal 2002, 2001 and 2000, respectively. Additionally, in January 2001, the Company purchased \$6.2 million of warehouse equipment (valued at original cost) from Barnes & Noble.com's Reno warehouse. In January 2002, Barnes & Noble.com determined it could not effectively utilize the full capacity of the Reno, Nevada distribution center. As a result, Barnes & Noble.com's Board of Directors approved the transfer of the Reno warehouse lease and the sale of inventory located in Reno to the Company. The Company purchased the inventory from Barnes & Noble.com at cost for \$9.9 million. In addition, the Company spent \$1.8 million to refurbish the facility. The Company's Board of Directors also approved the Company's assumption of the lease, which expires in 2010, and the hiring of all of the employees at the Reno facility. The Reno lease assignment and the transfer of the Reno facility to the Company was completed in April 2002. The Company intends to use the Reno facility to facilitate distribution to its current and future West Coast stores. In connection with the transition, Barnes & Noble.com agreed to pay one-half of the rent for the Reno facility through December 31, 2002. Barnes & Noble.com paid \$0.9 million in relation to these expenses for fiscal year 2002.

The Company subleases to Barnes & Noble.com approximately one-third of a 300,000-square-foot warehouse facility located in New Jersey. The Company has received from Barnes & Noble.com \$0.5 million annually for such subleased space during each of the fiscal years 2002, 2001 and 2000. The amount paid by Barnes & Noble.com to the Company approximates the cost per square foot paid by the Company as a tenant pursuant to the lease of the space from an unaffiliated third party.

The Company has entered into an agreement (the Supply Agreement) with Barnes & Noble.com whereby the Company charges Barnes & Noble.com the costs associated with such purchases plus

incremental overhead incurred by the Company in connection with providing such inventory. The Supply Agreement is subject to certain termination provisions. Barnes & Noble.com purchased \$108.3 million, \$119.3 million and \$110.5 million of merchandise from the Company during fiscal 2002, 2001 and 2000, respectively, and Barnes & Noble.com expects to source purchases through the Company in the future.

The Company has entered into agreements whereby Barnes & Noble.com receives various services from the Company, including, among others, services for payroll processing, benefits administration, insurance (property, casualty, medical, dental, life, etc.), tax, traffic, fulfillment and telecommunications. In accordance with the terms of such agreements, the Company has received, and expects to continue to receive, fees in an amount equal to the direct costs plus incremental expenses associated with providing such services. The Company received \$3.5 million, \$5.5 million and \$1.7 million for such services during fiscal 2002, 2001 and 2000, respectively.

The aggregate receivable (which is historically settled within 60 days) from Barnes & Noble.com in connection with the agreements described above was \$55.2 million and \$47.2 million as of February 1, 2003 and February 2, 2002, respectively.

The Company and Barnes & Noble.com commenced a marketing program in November 2000, whereby a customer purchases a "Readers' Advantage™ card" for an annual membership fee of \$25.00 which is non-refundable after the first 30 days of the membership term. With this card, customers can receive discounts of 10 percent on all Company purchases and 5 percent on all Barnes & Noble.com purchases. The Company and Barnes & Noble.com have agreed to share the expenses, net of revenue from the sale of the cards, related to this program in proportion to the discounts customers receive on purchases with each company.

In 2002, the Company through its wholly owned subsidiary, Marketing Services (Minnesota) Corp., entered into an agreement with Barnes & Noble.com for marketing services, which includes the issuance of gift cards. Under this agreement, the Company paid Barnes & Noble.com \$5.3 million during fiscal 2002, which represents reimbursement for gift cards purchased in a Barnes & Noble store and redeemed on the Barnes & Noble.com Web site.

Barnes & Noble.com, through its fulfillment centers, ships various customer orders for the Company to its retail stores as well as to the Company's customers' homes. Barnes & Noble.com charges the Company the costs associated with such shipments plus any incremental overhead incurred by Barnes & Noble.com to process these orders. The Company paid Barnes & Noble.com \$1.7 million, \$1.0 million and \$0.2 million for shipping and handling during fiscal years 2002, 2001 and 2000, respectively. In addition, during fiscal 2001, the Company and Barnes & Noble.com reached an agreement whereby the Company pays a commission on all items ordered by customers at the Company's stores and shipped directly to customers' homes by Barnes & Noble.com. Commissions paid for these sales were \$1.5 million and \$0.4 million during fiscal years 2002 and 2001, respectively.

The Company paid B&N College certain operating costs B&N College incurred on the Company's behalf. These charges are included in the accompanying consolidated statements of operations and approximated \$0.2 million, \$0.2 million and \$0.3 million for fiscal 2002, 2001 and 2000, respectively. B&N College purchased inventory, at cost plus an incremental fee, of \$44.9 million, \$41.5 million and \$17.2 million from the Company during fiscal 2002, 2001 and 2000, respectively. The Company charged B&N College \$2.1 million, \$1.5 million and \$1.3 million for fiscal years 2002, 2001 and 2000, respectively, for capital expenditures, business insurance and other operating costs incurred on its behalf.

The Company uses a jet aircraft owned by B&N College and pays for the costs and expenses of operating the aircraft based upon the Company's usage. Such costs which include fuel, insurance, personnel and other costs, approximated \$1.9 million, \$2.2 million and \$2.4 million during fiscal 2002, 2001 and 2000, respectively, and are included in the accompanying consolidated statements of operations.

In fiscal 1999, the Company acquired Babbage's Etc., one of the nation's largest video-game and entertainment-software specialty retailers, a company majority owned by Leonard Riggio, for \$208.7 million. An independent Special Committee of the Board of Directors negotiated and approved the acquisition on behalf of the Company. The Company made an additional payment of \$9.7 million in fiscal 2002 due to certain financial performance targets having been met during fiscal 2001. In fiscal 2000, the Company acquired Funco, Inc. Through a corporate restructuring, Babbage's Etc. became a wholly owned subsidiary of Funco, Inc. and the name of Funco, Inc. was changed to GameStop, Inc. In fiscal 2002, the Company completed an initial public offering of its GameStop subsidiary. The Company retained an approximate 63 percent interest in GameStop.

GameStop operates departments within some of the Company's bookstores. GameStop pays a license fee to the Company in an amount equal to 7 percent of the gross sales of such departments. The Company charged GameStop a license fee of \$1.1 million in fiscal 2002.

GameStop participates in the Company's worker's compensation, property and general liability insurance programs. The costs incurred by the Company under these programs are allocated to GameStop based upon GameStop's total payroll expense, property and equipment, and insurance claim history. During fiscal 2002, these charges amounted to \$1.7 million.

In fiscal 2001, Barnes & Noble.com and GameStop entered into an agreement whereby Barnes & Noble.com's Web site refers customers to the GameStop Web site for purchases of video-game hardware, software and accessories and PC-entertainment software. GameStop pays Barnes & Noble.com a referral fee based on its net sales revenue from certain eligible purchases made by customers as a result of the redirection from the Barnes & Noble.com Web site. Either party may terminate the agreement on 60 days' notice. Commissions were \$0.0 million and \$0.1 million for fiscal years 2002 and 2001, respectively.

The Company is provided with national freight distribution, including trucking, services by the LTA Group, Inc. (LTA), a company in which a brother of Leonard Riggio owns a 20 percent interest. The Company paid LTA \$18.5 million, \$17.7 million and \$16.7 million for such services during fiscal years 2002, 2001 and 2000, respectively. The Company believes the cost of freight delivered to the stores compares favorably to the prices charged by publishers and other third-party freight distributors.

Since 1993, the Company has used AEC One Stop Group, Inc. (AEC) as its primary music and DVD/video supplier and to provide a music and video database. AEC is one of the largest wholesale distributors of music and DVD/videos in the United States. In 1999, AEC's parent corporation was acquired by an investor group in which Leonard Riggio was a minority investor. The Company paid AEC \$246.4 million, \$169.9 million and \$160.8 million for merchandise purchased during fiscal 2002, 2001 and 2000, respectively. In addition, the Company paid AEC \$7.7 million, \$2.6 million and \$0.5 million for database equipment and services during fiscal 2002, 2001 and 2000, respectively. Amounts payable to AEC for merchandise purchased were \$22.0 million and \$51.1 million as of February 1, 2003 and February 2, 2002, respectively.

Newly Issued Accounting Pronouncements

In June 2002, the Financial Accounting Standards Board (FASB) finalized SFAS No. 146 "Accounting for the Costs Associated with Exit or Disposal Activities", which requires the Company to

recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. SFAS No. 146 replaces Emerging Issues Task Force (EITF) Issue No. 94-3 "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (Including Certain Costs Incurred in a Restructuring)". The provisions of SFAS No. 146 are to be applied prospectively to exit or disposal activities initiated after December 31, 2002. It is anticipated that the financial impact of SFAS No. 146 will not have a material effect on the Company.

In December 2002, the FASB issued SFAS No. 148 "Accounting for Stock-Based Compensation - Transition and Disclosure," which amends SFAS No. 123 "Stock-Based Compensation," to provide alternative methods of transition for a voluntary change to the fair value-based method of accounting for stock-based employee compensation. In addition, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The disclosure provisions of SFAS No. 148 are effective for fiscal years ending after December 15, 2002. The Company has incorporated these expanded disclosures into the footnotes to the Company's financial statements included herein.

In November 2002, the EITF reached a consensus on Issue 02-16 "Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor", addressing the accounting of cash consideration received by a customer from a vendor, including vendor rebates and refunds. The consensus reached states that consideration received should be presumed to be a reduction of the prices of the vendor's products or services and should therefore be shown as a reduction of cost of sales in the income statement of the customer. The presumption could be overcome if the vendor receives an identifiable benefit in exchange for the consideration or the consideration represents a reimbursement of a specific incremental identifiable cost incurred by the customer in selling the vendor's product or service. If one of these conditions is met, the cash consideration should be characterized as revenues or a reduction of such costs, as applicable, in the income statement of the customer. The consensus reached also concludes that rebates or refunds based on the customer achieving a specified level of purchases should be recognized as a reduction of cost of sales based on a systematic and rational allocation of the consideration to be received relative to the transactions that mark the progress of the customer toward earning the rebate or refund provided the amounts are probable and reasonably estimable. EITF Issue 02-16 is effective for arrangements entered into after December 31, 2002. Implementation of this standard is not expected to have a material effect on the Company's annual results of operations.

In November 2002, the FASB issued Interpretation No. 45 "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" (Interpretation 45). Interpretation 45 requires a guarantor to include disclosure of certain obligations, and if applicable, at the inception of the guarantee, recognize a liability for the fair value of other certain obligations undertaken in issuing a guarantee. The recognition requirement is effective for guarantees issued or modified after December 31, 2002 and is not expected to have a material impact on the Company.

In January 2003, the FASB issued Interpretation No. 46 "Consolidation of Variable Interest Entities" (Interpretation 46). Interpretation 46 clarifies the application of Accounting Research Bulletin No. 51 "Consolidated Financial Statements", and applies immediately to any variable interest entities created after January 31, 2003 and to variable interest entities in which an interest is obtained after that date. The Company holds no interest in variable interest entities.

Disclosure Regarding Forward-Looking Statements

This report may contain certain forward-looking statements (as such term is defined in the Private

Securities Litigation Reform Act of 1995) and information relating to the Company that are based on the beliefs of the management of the Company as well as assumptions made by and information currently available to the management of the Company. When used in this report, the words “anticipate,” “believe,” “estimate,” “expect,” “intend,” “plan” and similar expressions, as they relate to the Company or the management of the Company, identify forward-looking statements. Such statements reflect the current views of the Company with respect to future events, the outcome of which is subject to certain risks, including among others general economic and market conditions, decreased consumer demand for the Company’s products, possible disruptions in the Company’s computer or telephone systems, possible work stoppages or increases in labor costs, possible increases in shipping rates or interruptions in shipping service, effects of competition, possible disruptions or delays in the opening of new stores or the inability to obtain suitable sites for new stores, higher-than-anticipated store closing or relocation costs, higher interest rates, the performance of the Company’s online initiatives such as Barnes & Noble.com, the performance and successful integration of acquired businesses, the success of the Company’s strategic investments, unanticipated increases in merchandise or occupancy costs, unanticipated adverse litigation results or effects, and other factors which may be outside of the Company’s control. In addition, the video-game market has historically been cyclical in nature and dependent upon the introduction of new generation systems and related interactive software. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results or outcomes may vary materially from those described as anticipated, believed, estimated, expected, intended or planned. Subsequent written and oral forward-looking statements attributable to the Company or persons acting on its behalf are expressly qualified in their entirety by the cautionary statements in this paragraph.

CONSOLIDATED STATEMENTS OF OPERATIONS

Fiscal Year (Thousands of dollars, except per share data)	2002	2001	2000
Sales	\$ 5,269,335	4,870,390	4,375,804
Cost of sales and occupancy	3,855,842	3,560,038	3,169,724
Gross profit	1,413,493	1,310,352	1,206,080
Selling and administrative expenses	965,135	904,280	812,992
Legal settlement expense	—	4,500	—
Depreciation and amortization	148,691	147,826	144,760
Pre-opening expenses	10,227	7,959	7,669
Impairment charge	25,328	—	106,833
Operating profit	264,112	245,787	133,826
Interest (net of interest income of \$3,499, \$1,319 and \$939, respectively) and amortization of deferred financing fees	(21,506)	(36,334)	(53,541)
Equity in net loss of Barnes & Noble.com	(26,795)	(88,378)	(103,936)
Other expense	(16,498)	(11,730)	(9,346)
Earnings (loss) before taxes and minority interest	199,313	109,345	(32,997)
Income taxes	80,223	45,378	18,969
Earnings (loss) before minority interest	119,090	63,967	(51,966)
Minority interest	(19,142)	—	—
Net earnings (loss)	\$ 99,948	63,967	(51,966)
Earnings (loss) per common share			
Basic	\$ 1.51	0.96	(0.81)
Diluted	\$ 1.39	0.94	(0.81)
Weighted average common shares outstanding			
Basic	66,362,000	66,393,000	64,341,000
Diluted	77,680,000	77,839,000	64,341,000

See accompanying notes to consolidated financial statements.

CONSOLIDATED BALANCE SHEETS

(Thousands of dollars, except per share data)	February 1, 2003	February 2, 2002
Assets		
Current assets:		
Cash and cash equivalents	\$ 267,642	108,218
Receivables, net	66,948	51,366
Barnes & Noble.com receivable	55,174	47,204
Merchandise inventories	1,395,872	1,285,005
Prepaid expenses and other current assets	101,232	99,201
Total current assets	1,886,868	1,590,994
Property and equipment:		
Land and land improvements	3,247	3,247
Buildings and leasehold improvements	495,499	468,954
Fixtures and equipment	936,136	798,505
	1,434,882	1,270,706
Less accumulated depreciation and amortization	812,579	674,937
Net property and equipment	622,303	595,769
Goodwill	438,572	352,897
Investment in Barnes & Noble.com	23,280	48,217
Other noncurrent assets	24,404	35,343
Total assets	\$ 2,995,427	2,623,220
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	\$ 710,907	695,284
Accrued liabilities	520,541	444,944
Total current liabilities	1,231,448	1,140,228
Long-term debt	300,000	449,000
Deferred income taxes	119,823	36,178
Other long-term liabilities	115,415	109,704
Minority interest	200,951	—
Shareholders' equity:		
Common stock; \$.001 par value; 300,000,000 shares authorized; 73,110,740 and 72,713,069 shares issued, respectively	73	73
Additional paid-in capital	828,522	728,015
Accumulated other comprehensive loss	(11,064)	(14,303)
Retained earnings	391,650	291,702
Treasury stock, at cost, 8,502,700 and 5,504,700 shares, respectively	(181,391)	(117,377)
Total shareholders' equity	1,027,790	888,110
Commitments and contingencies	—	—
Total liabilities and shareholders' equity	\$ 2,995,427	2,623,220

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(Thousands of dollars)	Common Stock	Additional Paid-In Capital	Accumulated Other Comprehensive Loss	Retained Earnings	Treasury Stock at Cost	Total
Balance at January 29, 2000	\$ 70	654,584	(1,198)	279,701	(86,797)	846,360
Comprehensive earnings:						
Net loss	—	—	—	(51,966)	—	
Other comprehensive loss, net of tax (See Note 14):						
Unrealized loss on available-for-sale securities	—	—	(4,676)	—	—	
Total comprehensive loss						(56,642)
Exercise of 995,337 common stock options, including tax benefits of \$4,727	1	18,538	—	—	—	18,539
Treasury stock acquired, 1,478,800 shares	—	—	—	—	(30,580)	(30,580)
Balance at February 3, 2001	71	673,122	(5,874)	227,735	(117,377)	777,677
Comprehensive earnings:						
Net earnings	—	—	—	63,967	—	
Other comprehensive loss, net of tax (See Note 14):						
Unrealized loss on available-for-sale securities net of reclassification adjustment	—	—	(7,109)	—	—	
Unrealized loss on derivative instrument	—	—	(1,320)	—	—	
Total comprehensive earnings						55,538
Exercise of 2,163,893 common stock options, including tax benefits of \$15,769	2	54,893	—	—	—	54,895
Balance at February 2, 2002	73	728,015	(14,303)	291,702	(117,377)	888,110
Comprehensive earnings:						
Net earnings	—	—	—	99,948	—	
Other comprehensive loss, net of tax (See Note 14):						
Unrealized loss on available-for-sale securities net of reclassification adjustment	—	—	12,950	—	—	
Unrealized gain on derivative instrument	—	—	1,316	—	—	
Minimum pension liability	—	—	(11,027)	—	—	
Total comprehensive earnings						103,187
GameStop Corp. IPO (net of deferred income tax of \$65,306)	—	90,184	—	—	—	90,184
Exercise of 397,671 common stock options, including tax benefits of \$1,359	—	8,482	—	—	—	8,482
Exercise of common stock options of subsidiary, including tax benefits of \$1,201	—	1,841	—	—	—	1,841
Treasury stock acquired, 2,998,000 shares	—	—	—	—	(64,014)	(64,014)
Balance at February 1, 2003	\$ 73	828,522	(11,064)	391,650	(181,391)	1,027,790

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Fiscal Year (Thousands of dollars)	2002	2001	2000
Cash flows from operating activities:			
Net earnings (loss)	\$ 99,948	63,967	(51,966)
Adjustments to reconcile net earnings (loss) to net cash flows from operating activities:			
Depreciation and amortization (including amortization of deferred financing fees)	151,586	150,118	146,317
Loss on disposal of property and equipment	6,690	4,019	3,313
Deferred taxes	7,122	(32,131)	(54,098)
Impairment charge	25,328	—	106,833
Increase in other long-term liabilities for scheduled rent increases in long-term leases	2,822	5,829	9,417
Other expense, net	16,498	11,730	9,346
Equity in net loss of Barnes & Noble.com	26,795	88,378	103,936
Minority interest	19,142	—	—
Changes in operating assets and liabilities, net	(26,932)	165,481	(192,566)
Net cash flows from operating activities	<u>328,999</u>	<u>457,391</u>	<u>80,532</u>
Cash flows from investing activities:			
Acquisition of consolidated subsidiaries, net of cash received	(122,593)	(13,412)	(157,817)
Purchases of property and equipment	(179,545)	(168,833)	(134,292)
Proceeds from the partial sale of investments	—	6,072	2,962
Purchase of investments	(4,209)	(5,581)	(12,802)
Net increase in other noncurrent assets	(4,459)	(14,648)	(86)
Net cash flows from investing activities	<u>(310,806)</u>	<u>(196,402)</u>	<u>(302,035)</u>
Cash flows from financing activities:			
Proceeds from GameStop initial public offering	346,112	—	—
Net increase (decrease) in revolving credit facility	(149,000)	(517,900)	235,300
Proceeds from issuance of long-term debt	—	300,000	—
Proceeds from exercise of common stock options	8,133	39,126	18,539
Purchase of treasury stock through repurchase program	(64,014)	—	(30,580)
Net cash flows from financing activities	<u>141,231</u>	<u>(178,774)</u>	<u>223,259</u>
Net increase in cash and cash equivalents	159,424	82,215	1,756
Cash and cash equivalents at beginning of year	108,218	26,003	24,247
Cash and cash equivalents at end of year	<u>\$ 267,642</u>	<u>108,218</u>	<u>26,003</u>
Changes in operating assets and liabilities, net:			
Receivables, net	\$ (7,403)	(14,065)	(29,004)
Merchandise inventories	(94,281)	(46,387)	(103,668)
Prepaid expenses and other current assets	(4,914)	6,926	(29,972)
Accounts payable and accrued liabilities	79,666	219,007	(29,922)
Changes in operating assets and liabilities, net	<u>\$ (26,932)</u>	<u>165,481</u>	<u>(192,566)</u>
Supplemental cash flow information:			
Cash paid during the period for:			
Interest	\$ 20,377	29,867	49,007
Income taxes	\$ 78,525	43,646	73,371
Supplemental disclosure of subsidiaries acquired:			
Assets acquired	\$ 133,855	13,412	206,105
Liabilities assumed	11,262	—	48,288
Cash paid	<u>\$ 122,593</u>	<u>13,412</u>	<u>157,817</u>

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Thousands of dollars, except per share data)

For the 52 weeks ended February 1, 2003 (fiscal 2002), 52 weeks ended February 2, 2002 (fiscal 2001) and 53 weeks ended February 3, 2001 (fiscal 2000).

1. Summary of Significant Accounting Policies

Business

Barnes & Noble, Inc. (Barnes & Noble), through its subsidiaries (collectively, the Company), is primarily engaged in the sale of books, video games and entertainment-software products. The Company employs two principal bookselling strategies: its superstore strategy through its wholly owned subsidiary Barnes & Noble Booksellers, Inc., under its Barnes & Noble Booksellers, Bookstop and Bookstar trade names (hereafter collectively referred to as Barnes & Noble stores) and its mall strategy through its wholly owned subsidiaries B. Dalton Bookseller, Inc. and Doubleday Book Shops, Inc., under its B. Dalton stores, Doubleday Book Shops and Scribner's Bookstore trade names (hereafter collectively referred to as B. Dalton stores). The Company publishes books under its own imprints which, since January 2003, also include Sterling Publishing Co., Inc. and its various imprints. The Company is also engaged in the online retailing of books and other products through an approximate 38 percent interest in barnesandnoble.com llc (Barnes & Noble.com), as more fully described in Note 8. The Company, through its approximate 63 percent interest in GameStop Corp., operates video-game and entertainment-software stores under the GameStop, Babbage's, Software Etc. and FuncoLand trade names, a Web site (gamestop.com) and *Game Informer* magazine (hereafter collectively referred to as GameStop stores). Additionally, the Company owns an approximate 74 percent interest in Calendar Club L.L.C. (Calendar Club), an operator of seasonal calendar kiosks.

Consolidation

The consolidated financial statements include the accounts of Barnes & Noble and its wholly and majority-owned subsidiaries. Investments in affiliates in which ownership interests range from 20 percent to 50 percent, principally Barnes & Noble.com, are accounted for under the equity method. All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

In preparing financial statements in conformity with generally accepted accounting principles, the Company is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

The Company considers all short-term, highly liquid instruments purchased with an original maturity of three months or less to be cash equivalents.

Merchandise Inventories

Merchandise inventories are stated at the lower of cost or market. Cost is determined primarily by the retail inventory method on the first-in, first-out (FIFO) basis for 82 percent and 81 percent of the Company's merchandise inventories as of February 1, 2003 and February 2, 2002, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

Merchandise inventories of GameStop stores and Calendar Club represent 12 percent and 11 percent of merchandise inventories as of February 1, 2003 and February 2, 2002, respectively and are recorded based on the average cost method. The remaining merchandise inventories are valued on the last-in, first-out (LIFO) method.

If substantially all of the merchandise inventories currently valued at LIFO costs were valued at current costs, merchandise inventories would remain unchanged as of February 1, 2003 and February 2, 2002.

Property and Equipment

Property and equipment are carried at cost, less accumulated depreciation and amortization. For financial reporting purposes, depreciation is computed using the straight-line method over estimated useful lives. For tax purposes, different methods are used. Maintenance and repairs are expensed as incurred, while betterments and major remodeling costs are capitalized. Leasehold improvements are capitalized and amortized over the shorter of their estimated useful lives or the terms of the respective leases. Capitalized lease acquisition costs are being amortized over the lease terms of the underlying leases. Costs incurred in purchasing management information systems are capitalized and included in property and equipment. These costs are amortized over their estimated useful lives from the date the systems become operational.

Goodwill

The costs in excess of net assets of businesses acquired are carried as goodwill in the accompanying consolidated balance sheets.

In June 2001, the Financial Accounting Standards Board (FASB) finalized Statement of Financial Accounting Standards (SFAS) No. 141, "Business Combinations", and SFAS No. 142, "Goodwill and Other Intangible Assets". SFAS No. 141 requires business combinations initiated after June 30, 2001 to be accounted for using the purchase method of accounting, and broadens the criteria for recording intangible assets apart from goodwill. SFAS No. 142 requires that purchased goodwill and certain indefinite-lived intangibles no longer be amortized, but instead be tested for impairment at least annually. As a result of adopting SFAS No. 142, the Company ceased amortization of goodwill beginning February 3, 2002. Prior to the adoption of SFAS No. 142, the Company amortized goodwill on a straight-line basis over 30 to 40 years.

SFAS No. 142 prescribes a two-step process for impairment testing of goodwill. The first step of this test, used to identify potential impairment, compares the fair value of a reporting unit with its carrying amount, including goodwill. The second step (if necessary) measures the amount of the impairment. Using the guidance in SFAS No. 142, the Company has determined that it has two reporting units, bookstores and video-game and entertainment-software stores. The Company completed its initial impairment test on the goodwill in the second quarter of fiscal 2002 and its annual impairment test in November 2002. Both tests indicated that the fair value of the reporting units exceeded that reporting unit's carrying amount; accordingly, the second testing phase was not necessary. The Company has noted no subsequent indicators that would require testing goodwill for impairment.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

The effect of adoption of SFAS No. 142 on the reported net income (loss) is as follows:

Fiscal Year	2002	2001	2000
Reported net income (loss)	\$99,948	63,967	(51,966)
Add back: Amortization of goodwill, net of tax	—	7,419	7,367
Net income (loss), as adjusted	\$99,948	71,386	(44,599)
Basic earnings per share:			
Reported net income (loss)	\$ 1.51	0.96	(0.81)
Add back: Amortization of goodwill, net of tax	—	0.11	0.11
Net income (loss), as adjusted	\$ 1.51	1.07	(0.70)
Diluted earnings per share:			
Reported net income (loss)	\$ 1.39	0.94	(0.81)
Add back: Amortization of goodwill, net of tax	—	0.10	0.11
Net income (loss), as adjusted	\$ 1.39	1.04	(0.70)

Impairment of Long-Lived Assets

The Company's long-lived assets include property and equipment and goodwill. At February 1, 2003, the Company had \$622,303 of property and equipment, net of accumulated depreciation, and \$438,572 of goodwill, net of amortization, accounting for approximately 35.4% of the Company's total assets.

The Company periodically reviews its property and equipment under SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable or their depreciation periods should be accelerated. Factors that the Company considers important which could trigger a review include the following:

- Significant changes in the manner of use of the assets
- Significant changes in the strategy of the overall business
- Significant underperformance relative to expected historical or projected future operating results

Recoverability is assessed based on several factors, including management's intentions with respect to its stores and those stores' projected undiscounted cash flows. Assumptions underlying such projected cash flows include historical experience of stores, competitive environment, purchasing trends and projected demographics in the areas.

If it is determined that the carrying value of long-lived assets may not be recoverable, the Company measures impairment based on the present values of the projected cash flows using a discount rate determined by the Company's management to be commensurate with the risk involved.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

Deferred Charges

Costs incurred to obtain long-term financing are amortized over the terms of the respective debt agreements using the straight-line method, which approximates the interest method. Unamortized costs included in other noncurrent assets as of February 1, 2003 and February 2, 2002 were \$11,130 and \$10,436, respectively. Amortization expense included in interest and amortization of deferred financing fees were \$2,894, \$2,292 and \$1,557 during fiscal 2002, 2001 and 2000, respectively.

Derivative Instruments

Under an agreement which expired February 3, 2003, the Company used an interest-rate swap as a derivative to modify the interest characteristics of its outstanding floating rate debt, thereby reducing its exposure to fluctuations in interest rates. The Company's accounting policy was based on its designation of such instruments as cash flow hedges whereby changes in the fair value in the derivative have been included in other comprehensive income. The Company did not enter into the contract for speculative purposes.

Revenue Recognition

Revenue from sales of the Company's products is recognized at the time of sale. Sales returns (which are not significant) are recognized at the time returns are made.

Readers' Advantage™ membership entitles the customer to receive a 10 percent discount on all purchases made during the twelve-month membership period. The annual membership fee of \$25.00 is non-refundable after the first 30 days of the membership term. Revenue is being recognized over the twelve-month membership period based upon historical spending patterns for Barnes & Noble customers. Refunds of membership fees due to cancellations within the first 30 days are minimal.

Subscription revenue is recognized on a straight-line basis as magazine issues are delivered.

Advertising Costs

The costs of advertising are expensed as incurred during the year pursuant to Statement of Position 93-7, "Reporting on Advertising Costs". In addition, consideration received from vendors in conjunction with the Company's cooperative advertising program is netted against the related expenses. Advertising costs are charged to selling and administrative expenses. As a result of new requirements set forth in Emerging Issues Task Force (EITF) Issue 02-16 "Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor", which are effective for arrangements entered into after December 31, 2002, the Company may be required to reclassify some of its co-op advertising from an offset to selling and administrative expenses to a reduction in costs of sales and occupancy. The Company does not expect implementation of EITF Issue 02-16 to have a material effect on its annual results of operations.

Closed Store Expenses

Upon a formal decision to close or relocate a store, the Company charges unrecoverable costs to expense. Such costs include the net book value of abandoned fixtures and leasehold improvements and, when a store is closed, a provision for future lease obligations, net of expected sublease recoveries. Costs associated with store closings of \$10,111, \$9,831 and \$5,026 during fiscal 2002, fiscal 2001 and fiscal

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

2000, respectively, are included in selling and administrative expenses in the accompanying consolidated statements of operations.

Net Earnings Per Common Share

Basic earnings per share is computed by dividing income available to common shareholders by the weighted-average number of common shares outstanding. Diluted earnings per share reflect, in periods in which they have a dilutive effect, the impact of common shares issuable upon exercise of its stock options and those of its GameStop subsidiary, and assumes the conversion of the Company's 5.25% convertible subordinated notes for the period outstanding since their issuance in March 2001.

Income Taxes

The provision for income taxes includes federal, state and local income taxes currently payable and those deferred because of temporary differences between the financial statement and tax bases of assets and liabilities. The deferred tax assets and liabilities are measured using the enacted tax rates and laws that are expected to be in effect when the differences reverse.

Stock Options

The Company grants options to purchase Barnes & Noble, Inc. (BKS) and GameStop Corp. (GME) common shares under stock-based incentive plans, which are described more fully in Note 17. The Company accounts for all transactions under which employees receive shares of stock or other equity instruments in the Company or the Company incurs liabilities to employees in amounts based on the price of its stock in accordance with the provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees". The following table illustrates the effect on net income and earnings per share as if the Company had applied the fair value-recognition provisions of SFAS No. 123, "Accounting for Stock-Based Compensation", to stock-based incentive plans:

Fiscal Year	2002	2001	2000
Net earnings (loss) – as reported	\$99,948	63,967	(51,966)
Compensation expense, net of tax			
BKS stock options	15,985	9,972	8,676
GME stock options	4,676	8,300	65
Pro forma net earnings (loss) – pro forma for SFAS No. 123	\$79,287	45,695	(60,707)
Net earnings (loss) per diluted share – as reported	\$ 1.39	0.94	(0.81)
Compensation expense, net of tax			
BKS stock options	0.21	0.13	0.13
GME stock options	0.06	0.11	0.00
Pro forma net earnings (loss) per diluted share – pro forma for SFAS No. 123	\$ 1.12	0.70	(0.94)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

Reclassifications

Certain prior-period amounts have been reclassified for comparative purposes to conform with the fiscal 2002 presentation.

Reporting Period

The Company's fiscal year is comprised of 52 or 53 weeks, ending on the Saturday closest to the last day of January. The reporting periods ended February 1, 2003, February 2, 2002 and February 3, 2001 contained 52 weeks, 52 weeks and 53 weeks, respectively.

Newly Issued Accounting Pronouncements

In June 2002, the FASB finalized SFAS No. 146 "Accounting for the Costs Associated with Exit or Disposal Activities", which requires the Company to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. SFAS No. 146 replaces EITF Issue No. 94-3 "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (Including Certain Costs Incurred in a Restructuring)". The provisions of SFAS No. 146 are to be applied prospectively to exit or disposal activities initiated after December 31, 2002. It is anticipated that the financial impact of SFAS No. 146 will not have a material effect on the Company.

In December 2002, the FASB issued SFAS No. 148 "Accounting for Stock-Based Compensation - Transition and Disclosure," which amends SFAS No. 123 "Stock-Based Compensation," to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The disclosure provisions of SFAS No. 148 are effective for fiscal years ending after December 15, 2002. The Company has incorporated the expanded disclosures into these footnotes.

In November 2002, the EITF reached a consensus on Issue 02-16 "Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor", addressing the accounting of cash consideration received by a customer from a vendor, including vendor rebates and refunds. The consensus reached states that consideration received should be presumed to be a reduction of the prices of the vendor's products or services and should therefore be shown as a reduction of cost of sales in the income statement of the customer. The presumption could be overcome if the vendor receives an identifiable benefit in exchange for the consideration or the consideration represents a reimbursement of a specific incremental identifiable cost incurred by the customer in selling the vendor's product or service. If one of these conditions is met, the cash consideration should be characterized as revenues or a reduction of such costs, as applicable, in the income statement of the customer. The consensus reached also concludes that rebates or refunds based on the customer achieving a specified level of purchases should be recognized as a reduction of cost of sales based on a systematic and rational allocation of the consideration to be received relative to the transactions that mark the progress of the customer toward earning the rebate or refund provided the amounts are probable and reasonably estimable. EITF Issue 02-16 is effective for arrangements entered into after December 31, 2002. Implementation of this standard is not expected to have a material effect on the Company's annual results of operations.

In November 2002, the FASB issued Interpretation No. 45 "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" (Interpretation 45). Interpretation 45 requires a guarantor to include disclosure of certain obligations, and

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

if applicable, at the inception of the guarantee, recognize a liability for the fair value of other certain obligations undertaken in issuing a guarantee. The recognition requirement is effective for guarantees issued or modified after December 31, 2002 and is not expected to have a material impact on the Company.

In January 2003, the FASB issued Interpretation No. 46 "Consolidation of Variable Interest Entities" (Interpretation 46). Interpretation 46 clarifies the application of Accounting Research Bulletin No. 51 "Consolidated Financial Statements", and applies immediately to any variable interest entities created after January 31, 2003 and to variable interest entities in which an interest is obtained after that date. The Company holds no interest in variable interest entities.

2. Receivables, Net

Receivables represent customer, credit card, landlord and other receivables due within one year as follows:

	February 1, 2003	February 2, 2002
Trade accounts	\$ 20,534	5,594
Credit card receivables (a)	27,382	26,632
Receivables from landlords for leasehold improvements	9,800	10,407
Other receivables	9,232	8,733
Total receivables, net	\$ 66,948	51,366

(a) Credit card receivables consist of receivables from credit card companies. The Company assumes no customer credit risk for these receivables.

3. Debt

On May 22, 2002, the Company obtained a \$500,000 three-year senior revolving credit facility (the Facility) with a syndicate of banks led by Fleet National Bank as administrative agent. The Facility, which expires in May 2005, replaced the Company's \$850,000 five-year senior revolving credit facility obtained on November 18, 1997. The Facility permits borrowings at various interest-rate options based on the prime rate or London Interbank Offer Rate (LIBOR) plus applicable margin depending upon the level of the Company's fixed charge coverage ratio. The Company's fixed charge coverage is calculated as the ratio of earnings before interest, taxes, depreciation, amortization and rents to interest plus rents. In addition, the Facility requires the Company to pay a commitment fee of 0.25 percent, which fee varies based upon the Company's fixed charge coverage ratio, calculated as a percentage of the unused portion. The Company is required to pay utilization fees of 0.125 percent or 0.25 percent on all outstanding loans under the Facility if the aggregate outstanding loans are greater than 33 percent and 66 percent, respectively, of the aggregate amount of the Facility.

A portion of the Facility, not to exceed \$100,000, is available for the issuance of letters of credit. Also, under certain circumstances, the Company may be permitted to increase the size of the Facility to an amount not to exceed \$600,000 and/or to extend the term of the Facility by one additional year.

Mandatory prepayments include the requirement that loans outstanding under the Facility be reduced by 100 percent of the net cash proceeds from (i) the disposition of the Company's stock in certain entities, (ii) any equity issuance, and (iii) the disposition of certain other material assets, other than those assets disposed of during the ordinary course of business. Under certain circumstances, mandatory

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

commitment reductions may include the requirement that the aggregate size of the Facility be reduced upon the disposition by the Company of its stock in GameStop.

The Facility contains covenants, limitations and events of default typical of credit facilities of this size and nature, including financial covenants, which require the Company to meet, among other things, leverage and fixed charge coverage ratios and which limit capital expenditures. Negative covenants include limitations on other indebtedness, liens, investments, mergers, consolidations, sales or leases of assets, acquisitions, distributions and dividends and other payments in respect of capital stock, transactions with affiliates, and sale/leaseback transactions. In the event the Company defaults on these financial covenants, all outstanding borrowings under the Facility may become immediately payable and no further borrowings may be available. The Facility is secured by the Company's capital stock in its subsidiaries, and by the accounts receivable and certain general intangibles of the Company and its subsidiaries. Net proceeds from the Facility are available for general corporate purposes.

In fiscal 2001, the Company issued \$300,000, 5.25 percent convertible subordinated notes due March 15, 2009. The notes are convertible into the Company's common stock at a conversion price of \$32.512 per share.

In fiscal 2000, the Company obtained an additional \$100,000 senior unsecured seasonal credit facility (seasonal credit facility) with a syndicate of banks led by The Chase Manhattan Bank. The seasonal credit facility, which matured on January 31, 2001, permitted for borrowings at an interest rate based on LIBOR. In addition, the agreement required the Company to pay a commitment fee of 0.375 percent of the unused portion. The seasonal credit facility was guaranteed by all restricted subsidiaries of Barnes & Noble.

The Company from time to time enters into interest rate swap agreements to manage interest-costs and risk associated with changes in interest rates. These agreements effectively convert underlying variable-rate debt based on prime rate or LIBOR to fixed-rate debt through the exchange of fixed and floating interest payment obligations without the exchange of underlying principal amounts. For each of the years ended February 1, 2003 and February 2, 2002, the Company had a notional amount outstanding of \$55,000 in swaps, maturing on February 3, 2003.

Selected information related to the Company's convertible subordinated notes, revolving credit facility and seasonal credit facility is as follows:

Fiscal Year	2002	2001	2000
Balance at end of year	\$300,000	449,000	666,900
Average balance outstanding during the year	\$377,297	689,326	697,832
Maximum borrowings outstanding during the year	\$490,300	870,000	918,700
Weighted average interest rate during the year	5.70%	5.27%	7.55%
Interest rate at end of year	5.25%	4.33%	6.01%

Fees expensed with respect to the unused portion of the Company's revolving credit commitment were \$999, \$516 and \$272, during fiscal 2002, 2001 and 2000, respectively.

The amounts outstanding under the Company's revolving credit facility have been classified as long-term debt based on the Company's intention and ability to maintain principal amounts outstanding.

The Company has no agreements to maintain compensating balances.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

4. Fair Values of Financial Instruments

The carrying values of cash and cash equivalents reported in the accompanying consolidated balance sheets approximate fair value due to the short-term maturities of these assets. The aggregate fair value of the Revolving Credit Facility approximates its carrying amount, because of its recent and frequent repricing based upon market conditions.

Interest-rate swap agreements are valued based on market quotes obtained from dealers. The estimated fair value of the interest-rate swaps liability was \$6 and \$2,256 at February 1, 2003 and February 2, 2002, respectively. The interest-rate swaps are included as a component of other long-term liabilities.

5. Other Expense

The following table sets forth the components of other expense, in thousands of dollars:

Fiscal Year	2002	2001	2000
iUniverse.com (1) (2)	\$ (8,489)	(3,985)	(9,277)
Equity in net losses of <i>BOOK</i> ® magazine (2) (3)	(5,081)	(2,500)	(127)
Equity in net losses of enews, inc. (2) (4)	(2,351)	(5,581)	—
Other	(577)	336	58
Total other expense	<u>\$(16,498)</u>	<u>(11,730)</u>	<u>(9,346)</u>

- (1) The Company has a 22 percent ownership interest in iUniverse.com. This investment is being accounted for under the equity method.
- (2) During fiscal 2002, the Company determined that a decrease in value of its investment occurred which is other than temporary. This resulted in the recognition of losses in excess of what would otherwise be recognized by application of the equity method in accordance with Accounting Principles Board Opinion No. 18, "The Equity Method of Accounting for Investments in Common Stock." The investment balance is \$0 at February 1, 2003.
- (3) The Company has a 50 percent interest in *BOOK*® magazine. This investment is being accounted for under the equity method.
- (4) The Company has a 49 percent interest in enews, inc. This investment is being accounted for under the equity method.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

6. Marketable Equity Securities

Marketable equity securities are carried on the balance sheet at their fair market value as a component of other noncurrent assets. The following marketable equity securities as of February 1, 2003 and February 2, 2002 have been classified as available-for-sale securities:

	Fiscal 2002		
	Gemstar International Ltd.	Indigo Books & Music Inc.	Total
Carrying value	\$ 27,137	2,558	29,695
Impairment charge	(23,828)	(1,500)	(25,328)
Realized loss on sale of investment	(3,309)	(279)	(3,588)
Unrealized loss	—	(61)	(61)
Market value at February 1, 2003	\$ —	718	718

	Fiscal 2001		
	Gemstar International Ltd.	Indigo Books & Music Inc. (formerly Chapters Inc.)	Total
Carrying value	\$ 27,137	8,294	35,431
Partial sale of investment	—	(5,736)	(5,736)
Unrealized loss	(20,256)	(1,926)	(22,182)
Market value at February 2, 2002	\$ 6,881	632	7,513

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

7. Net Earnings Per Share

Following is a reconciliation of net earnings and weighted average common shares outstanding for purposes of calculating basic and diluted earnings per share:

Fiscal Year	2002			2001		
	Income (Numerator)	Shares (Denominator)	Per Share Amount	Income (Numerator)	Shares (Denominator)	Per Share Amount
Basic EPS						
Net income	\$ 99,948	66,362	\$ 1.51	\$63,967	66,393	\$ 0.96
Effect of dilutive securities						
Options	—	2,091		—	3,207	
Convertible debt	10,249(a)	9,227		8,821(a)	8,239	
	<u>110,197</u>			<u>72,788</u>		
Effect of GameStop dilutive EPS (b)						
GameStop net income less minority interest	33,262			—		
	<u>76,935</u>			<u>72,788</u>		
GameStop diluted EPS	\$ 0.87					
GameStop shares owned by Barnes & Noble	36,009	31,328		—		
	<u>\$108,263</u>	<u>77,680</u>	<u>\$ 1.39</u>	<u>\$72,788</u>	<u>77,839</u>	<u>\$ 0.94</u>

(a) Represents interest on convertible subordinated notes, net of taxes.

(b) In February 2002, GameStop completed an initial public offering (IPO). Prior to the IPO, GameStop was a consolidated wholly-owned subsidiary of Barnes & Noble, Inc.

8. Barnes & Noble.com

On November 12, 1998, the Company and Bertelsmann AG (Bertelsmann) completed the formation of a limited liability company to operate the online retail bookselling operations of the Company's wholly owned subsidiary, barnesandnoble.com inc. The new entity, barnesandnoble.com llc (Barnes & Noble.com), was structured as a limited liability company. Under the terms of the relevant agreements, effective as of October 31, 1998, the Company and Bertelsmann each retained a 50 percent membership interest in Barnes & Noble.com. The Company contributed substantially all of the assets and liabilities of its online operations to the joint venture and Bertelsmann paid \$75,000 to the Company and made a \$150,000 cash contribution to the joint venture. Bertelsmann also agreed to contribute an additional \$50,000 to the joint venture for future working capital requirements. The Company recognized a pre-tax gain during fiscal 1998 in the amount of \$126,435, of which \$63,759 was recognized in earnings based on the \$75,000 received directly and \$62,676 (\$36,351 after taxes) was reflected in additional paid-in capital based on the Company's share of the incremental equity of the joint venture resulting from the \$150,000 Bertelsmann contribution.

On May 25, 1999, Barnes & Noble.com Inc. completed an IPO of 28.75 million shares of Class A Common Stock and used the proceeds to purchase a 20 percent interest in Barnes & Noble.com. As a result, the Company and Bertelsmann each retained a 40 percent interest in Barnes & Noble.com. The

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

Company recorded an increase in additional paid-in capital of \$116,158 after taxes representing the Company's incremental share in the equity of Barnes & Noble.com. In November 2000, Barnes & Noble.com acquired Fatbrain.com, Inc. (Fatbrain), the third largest online bookseller. Barnes & Noble.com issued shares of its common stock to Fatbrain shareholders. As a result of this merger, the Company and Bertelsmann each retained an approximate 36 percent interest in Barnes & Noble.com. In October 2002, the Company announced its intent to purchase up to \$10,000 of Barnes & Noble.com Class A Common Stock in the open market or through privately negotiated transactions. As of February 1, 2003, the Company purchased approximately 1.7 million shares of Barnes & Noble.com Class A Common Stock. Subsequent to the fiscal 2002 year end, the Company purchased additional shares and currently has a 38 percent interest in Barnes & Noble.com. The Company will continue to account for its investment under the equity method.

Under the terms of the November 12, 1998 joint venture agreement between the Company and Bertelsmann, the Company received a \$25,000 payment from Bertelsmann in connection with the IPO. The Company recognized the \$25,000 pre-tax gain in fiscal 1999. The estimated fair market values of the Company's investment in Barnes & Noble.com were \$60,386, \$109,825 and \$122,000 at February 1, 2003, February 2, 2002 and February 3, 2001, respectively.

Summarized financial information for Barnes & Noble.com follows:

	12 months ended December 31,		
	2002	2001	2000
Net sales	\$422,827	404,600	320,115
Gross profit	\$ 95,569	91,235	58,314
Net loss (a)	\$ (20,132)	(67,386)	(65,403)
Cash and cash equivalents	\$ 70,144	115,266	212,304
Other current assets	66,925	68,135	80,332
Noncurrent assets	72,665	103,975	236,299
Current liabilities	134,788	138,773	135,987
Minority interest	52,305	105,845	282,824
Net assets	\$ 22,641	42,758	110,124

(a) Includes impairment charge of \$88,213 and \$75,051 in 2001 and 2000, respectively.

9. Employees' Retirement and Defined Contribution Plans

As of December 31, 1999, substantially all employees of the Company were covered under a noncontributory defined benefit pension plan (the Pension Plan). As of January 1, 2000, the Pension Plan was amended so that employees no longer earn benefits for subsequent service. Subsequent service continues to be the basis for vesting of benefits not yet vested at December 31, 1999 and the Pension Plan will continue to hold assets and pay benefits. The amendment was treated as a curtailment in fiscal 1999 resulting in a pre-tax gain of \$14,142 which is included as a reduction of selling and administrative expenses.

The Company maintains defined contribution plans (the Savings Plans) for the benefit of substantially all employees. In addition, the Company provides certain health care and life insurance benefits (the Postretirement Plan) to retired employees, limited to those receiving benefits or retired as of April 1, 1993.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

A summary of the components of net periodic cost for the Pension Plan and the Postretirement Plan follows:

Fiscal Year	Pension Plan			Postretirement Plan		
	2002	2001	2000	2002	2001	2000
Service cost	\$ —	—	—	—	—	—
Interest cost	1,951	1,869	1,779	251	175	151
Expected return on plan assets	(2,726)	(3,030)	(2,887)	—	—	—
Net amortization and deferral	536	43	—	6	(73)	(104)
Net periodic expense (income)	(239)	(1,118)	(1,108)	257	102	47
FAS 88 curtailment income	—	831	—	—	—	—
Total income	\$ (239)	(287)	(1,108)	257	102	47

Total Company contributions charged to employee benefit expenses for the Savings Plans were \$6,709, \$5,929 and \$5,681 during fiscal 2002, 2001 and 2000, respectively.

Weighted-average actuarial assumptions used in determining the net periodic costs of the Pension Plan and the Postretirement Plan are as follows:

Fiscal Year	Pension Plan			Postretirement Plan		
	2002	2001	2000	2002	2001	2000
Discount rate	6.5%	7.3%	7.8%	7.3%	7.3%	7.8%
Expected return on plan assets	9.0%	9.5%	9.5%	—	—	—
Assumed rate of compensation increase*	N/A	N/A	4.8%	—	—	—

* A graded salary scale was used.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

The following table provides a reconciliation of benefit obligations, plan assets and funded status of the Pension Plan and the Postretirement Plan:

Fiscal Year	Pension Plan		Postretirement Plan	
	2002	2001	2002	2001
Change in benefit obligation:				
Benefit obligation at beginning of year	\$26,499	24,187	2,541	2,081
Interest cost	1,951	1,869	251	175
Actuarial loss	4,643	2,525	1,438	569
Benefits paid	(1,445)	(419)	(329)	(284)
Settlement	—	(1,663)	—	—
Benefit obligation at end of year	\$31,648	26,499	3,901	2,541
Change in plan assets:				
Fair value of plan assets at beginning of year	\$28,973	32,114	—	—
Actual loss on assets	(2,221)	(379)	—	—
Employer contributions	—	—	—	—
Settlement	—	(2,343)	—	—
Benefits paid	(1,446)	(419)	—	—
Fair value of plan assets at end of year	\$25,306	28,973	—	—
Funded status	\$ (6,342)	2,474	(3,901)	(2,541)
Unrecognized net actuarial (gain) loss	18,456	9,401	491	(941)
Net amount recognized	\$12,114	11,875	(3,410)	(3,482)
Amounts recognized in the statement of financial position consist of:				
Prepaid (accrued) benefit cost	\$ —	11,875	(3,410)	(3,482)
Accrued benefit liability	(6,342)	—	—	—
Accumulated other comprehensive income	18,456	—	—	—
Net amount recognized	\$12,114	11,875	(3,410)	(3,482)

Settlements in the form of lump sum cash payments were made in fiscal 2001 to plan participants in exchange for their rights to receive specified pension benefits.

The health-care cost trend rate used to measure the expected cost of the Postretirement Plan benefits is assumed to be nine percent in 2002 declining at one percent decrements each year through 2005 and one-half percent decrements through 2007 to five percent in 2007 and each year thereafter. The health-care cost trend assumption has a significant effect on the amounts reported. For example, a one percent increase or decrease in the health-care cost trend rate would change the accumulated postretirement benefit obligation by approximately \$328 and \$291, respectively, as of February 1, 2003, and would change the net periodic cost by approximately \$22 and \$19, respectively, during fiscal 2002.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

10. Income Taxes

The Company files a consolidated federal return with all 80 percent or more owned subsidiaries. Federal and state income tax provisions (benefits) for fiscal 2002, 2001 and 2000 are as follows:

Fiscal Year	2002	2001	2000
Current:			
Federal	\$59,598	62,141	59,055
State	13,503	13,891	13,086
	<u>73,101</u>	<u>76,032</u>	<u>72,141</u>
Deferred:			
Federal	6,311	(25,790)	(44,390)
State	811	(4,864)	(8,782)
	<u>7,122</u>	<u>(30,654)</u>	<u>(53,172)</u>
Total	<u>\$80,223</u>	<u>45,378</u>	<u>18,969</u>

A reconciliation between the provision (benefit) for income taxes and the expected provision for income taxes at the federal statutory rate of 35 percent during fiscal 2002, 2001 and 2000, is as follows:

Fiscal Year	2002	2001	2000
Expected provision (benefit) for income taxes at federal statutory rate	\$69,760	38,271	(11,549)
Amortization of non-deductible goodwill and trade names and write-down of goodwill	—	1,987	26,669
State income taxes, net of federal income tax benefit	9,304	5,868	2,798
GameStop undistributed earnings	2,332	—	—
Other, net	(1,173)	(748)	1,051
Provision for income taxes	<u>\$80,223</u>	<u>45,378</u>	<u>18,969</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

The tax effects of temporary differences that give rise to significant components of the Company's deferred tax assets and liabilities as of February 1, 2003 and February 2, 2002 are as follows:

	February 1, 2003	February 2, 2002
Deferred tax liabilities:		
Operating expenses	\$ (23,175)	(19,655)
Depreciation	(31,697)	(22,278)
Gain on equity increase in GameStop	(65,306)	—
Investment in Barnes & Noble.com	(41,253)	(32,572)
Goodwill amortization	(11,241)	(6,132)
Pension	—	(5,149)
GameStop undistributed earnings	(2,332)	—
Total deferred tax liabilities	(175,004)	(85,786)
Deferred tax assets:		
Lease transactions	26,260	23,446
Investments in equity securities	15,597	9,072
Estimated accruals	11,638	5,573
Restructuring charge	12,853	13,496
Inventory	19,116	15,408
Pension	2,296	—
Insurance liability	6,824	2,312
Unrealized holding losses on available-for-sale securities	26	9,199
Unrealized holding loss on derivative instrument	2	936
Other	187	913
Total deferred tax assets	94,799	80,355
Net deferred tax liabilities	\$ (80,205)	(5,431)

Deferred income taxes are classified on the Company's balance sheet as follows:

	February 1, 2003	February 2, 2002
Short-term deferred tax assets (a)	\$ 39,618	30,747
Long-term deferred tax liabilities	(119,823)	(36,178)
	\$ (80,205)	(5,431)

(a) Reflected as a component of prepaid expenses and other current assets on the accompanying balance sheet.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

11. Acquisitions

On January 21, 2003, the Company completed its acquisition of Sterling Publishing, one of the top 25 publishers in the nation and the industry's leading publisher of how-to books, for \$122,593 including \$7,415 paid to reduce short-term debt. The acquisition was accounted for by the purchase method of accounting and, accordingly, the results of operations for the period subsequent to the acquisition are included in the consolidated financial statements. The excess of purchase price over the net assets acquired of approximately \$45,000 has been recorded as goodwill and will be tested annually for impairment in accordance with SFAS No. 142. The Company has engaged a firm to perform an independent allocation of purchased intangibles between finite- and indefinite-lived assets. Assets determined to have a finite life will be amortized over their useful lives. The impact of amortization expense on the Company's annual earnings is not expected to be material. The pro forma effect assuming the acquisition of Sterling Publishing at the beginning of fiscal 2001 is not material.

12. GameStop Initial Public Offering

In fiscal 1999, the Company acquired Babbage's Etc., one of the nation's largest video-game and entertainment-software specialty retailers, a company majority owned by Leonard Riggio, for \$208,670. An independent Special Committee of the Board of Directors negotiated and approved the acquisition on behalf of the Company. The Company made an additional payment of \$9,665 in 2002 due to certain financial performance targets having been met during fiscal year 2001.

On June 14, 2000, the Company acquired all of the outstanding shares of Funco, Inc., a Minneapolis-based electronic games retailer for approximately \$167,560. The acquisition was accounted for by the purchase method of accounting and, accordingly, the results of operations for the period subsequent to the acquisition are included in the consolidated financial statements. The excess of purchase price over the net assets acquired, in the amount of approximately \$131,400, has been recorded as goodwill and is tested for impairment at least annually, in conformity with SFAS No. 142.

Through a corporate restructuring, Babbage's Etc. became a wholly owned subsidiary of Funco, Inc. and the name of Funco, Inc. was changed to GameStop, Inc.

In February 2002, GameStop completed an initial public offering of shares of its Class A common stock at a price of \$18.00 per share, raising net proceeds of approximately \$348,000. A portion of the net proceeds was used to repay \$250,000 of indebtedness to the Company, with the Company contributing the remaining \$150,000 of indebtedness to GameStop as additional paid-in capital. The balance of the net proceeds (approximately \$98,000) is being used for working capital and general corporate purposes for GameStop. The Company owns approximately 63 percent of the outstanding shares of GameStop's capital stock through its ownership of 100 percent of GameStop's Class B common stock, which represents 94.5 percent of the combined voting power of all classes of GameStop voting stock. The Company recorded an increase in additional paid-in capital of \$155,490 (\$90,184 after taxes), representing the Company's incremental share in the equity of GameStop.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

13. Segment Information

The Company operates under two strategic groups that offer different products. These groups have been aggregated into two reportable operating segments: bookstores and video-game and entertainment-software stores.

Bookstores

This segment includes 628 bookstores under the Barnes & Noble Booksellers, Bookstop and Bookstar names which generally offer a comprehensive title base, a café, a children's section, a music department, a magazine section and a calendar of ongoing events, including author appearances and children's activities. This segment also includes 258 small format mall-based stores under the B. Dalton Bookseller, Doubleday Book Shops and Scribner's Bookstore trade names. The Company's publishing operation is also included in this segment. Additionally, this segment includes the operations of Calendar Club, the Company's majority-owned subsidiary. Calendar Club is an operator of seasonal calendar kiosks. The bookstore segment employs a merchandising strategy that targets the mainstream consumer book market.

Video-Game and Entertainment-Software Stores

This segment includes 1,231 Video Game & Entertainment Software stores under the Babbage's, Software Etc., GameStop and FuncoLand names, a Web site (gamestop.com) and *Game Informer* magazine. The principal products of these stores are comprised of video-game hardware and software and PC-entertainment software. The Company's consolidated financial statements reflect the results of Babbage's Etc. from October 1999 and Funco, Inc. from June 2000, the respective dates of acquisition.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies. Segment operating profit includes corporate expenses in each operating segment. Barnes & Noble evaluates the performance of its segments and allocates resources to them based on operating profit.

Summarized financial information concerning the Company's reportable segments is presented below:

Fiscal Year	Sales			Depreciation and Amortization		
	2002	2001	2000	2002	2001	2000
Bookstores	\$3,916,544	3,748,992	3,618,240	\$126,138	117,529	122,563
Video Game & Entertainment Software stores	1,352,791	1,121,398	757,564	22,553	30,297	22,197
Total	\$5,269,335	4,870,390	4,375,804	\$148,691	147,826	144,760

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

Fiscal Year	Operating Profit			Equity Investment in Barnes & Noble.com		
	2002	2001	2000	2002	2001	2000
Bookstores *	\$177,041	211,700	127,812	\$23,280	48,217	136,595
<i>Operating margin</i>	4.52%	5.65%	3.53%			
Video Game & Entertainment						
Software stores	87,071	34,087	6,014	—	—	—
<i>Operating margin</i>	6.44%	3.04%	0.79%			
Total	\$264,112	245,787	133,826	\$23,280	48,217	136,595

Fiscal Year	Capital Expenditures			Total Assets		
	2002	2001	2000	2002	2001	2000
Bookstores	\$140,016	148,371	109,161	\$2,191,533	2,026,123	2,049,639
Video Game & Entertainment						
Software stores	39,529	20,462	25,131	803,894	597,097	507,837
Total	\$179,545	168,833	134,292	\$2,995,427	2,623,220	2,557,476

* Fiscal 2002 operating profit is net of an impairment charge of \$25,328. Excluding the impairment charge, fiscal 2002 operating profit would have been \$202,369. Fiscal 2001 operating profit is net of legal settlement expense of \$4,500. Excluding the legal settlement expense, fiscal 2001 operating profit would have been \$216,200. Fiscal 2000 operating profit is net of a non-cash impairment charge of \$106,833. Excluding the non-cash impairment charge, fiscal 2000 operating profit would have been \$234,645.

A reconciliation of operating profit from reportable segments to earnings before income taxes and cumulative effect of a change in accounting principle in the consolidated financial statements is as follows:

Fiscal Year	2002	2001	2000
Reportable segments operating profit	\$264,112	245,787	133,826
Interest, net	(21,506)	(36,334)	(53,541)
Equity in net loss of Barnes & Noble.com	(26,795)	(88,378)	(103,936)
Other expense	(16,498)	(11,730)	(9,346)
Consolidated earnings (loss) before income taxes and minority interest	\$199,313	109,345	(32,997)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

14. Comprehensive Earnings (Loss)

Comprehensive earnings are net earnings, plus certain other items that are recorded directly to shareholders' equity. The only such items currently applicable to the Company are the unrealized losses on available-for-sale securities and derivative instruments, as follows:

Fiscal Year	2002	2001	2000
Net earnings (loss)	\$ 99,948	63,967	(51,966)
Other comprehensive loss:			
Unrealized loss on available-for-sale securities (net of deferred tax benefit of \$1,292, \$5,437 and \$3,317, respectively)	(1,859)	(7,665)	(4,676)
Less: reclassification adjustment (net of deferred income tax expense of \$10,465, \$395 and \$0, respectively)	14,809	556	—
	<u>12,950</u>	<u>(7,109)</u>	<u>(4,676)</u>
Unrealized loss on derivative instrument (net of deferred tax of \$931, \$936 and \$0, respectively)	1,316	(1,320)	—
Minimum pension liability (net of deferred tax benefit of \$7,429)	(11,027)	—	—
Total comprehensive earnings (loss)	<u>\$103,187</u>	<u>55,538</u>	<u>(56,642)</u>

15. Shareholders' Equity

In fiscal 1999, the Board of Directors authorized a common stock repurchase program for the purchase of up to \$250,000 of the Company's common shares. As of February 1, 2003, the Company has repurchased 8,502,700 shares at a cost of approximately \$181,391 under this program. The repurchased shares are held in treasury.

Each share of the Company's Common Stock also entitles the holder to the right (the Right) to purchase one four-hundredth of a share of the Company's Series H Preferred Stock for \$225. The Right is only exercisable if a person or group acquires 15 percent or more of the Company's outstanding Common Stock or announces a tender offer or exchange offer, the consummation of which would result in such person or group owning 15 percent or more of the Company's outstanding Common Stock.

16. Impairment Charge

During the first quarter of fiscal 2002, the Company deemed the decline in value in its available-for-sale securities in Gemstar-TV Guide International, Inc. (Gemstar) and Indigo Books & Music Inc. (Indigo) to be other than temporary. The investments had been carried at fair market value with unrealized gains and losses included in shareholders' equity. Events such as Gemstar's largest shareholder taking an impairment charge for its investment, the precipitous decline in the stock price subsequent to the abrupt resignation of one of its senior executives, the questioning of aggressive revenue recognition policies and the filing of a class action lawsuit against Gemstar, were among the items which led to management's decision to record an impairment for its investment in Gemstar of nearly \$24,000 (before taxes). The Company's decision to record an impairment charge for its investment in Indigo was based on a review of Indigo's financial condition and historical share trading data. As a result, the

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

Company recorded a non-cash impairment charge to operating earnings of \$25,328 (\$14,944 after taxes) to reclassify the accumulated unrealized losses and to write down the investments to their current fair market value at the close of business on May 4, 2002. In the second quarter of fiscal 2002, the Company sold its investment in Gemstar resulting in a loss of \$297.

During fiscal 2000, the Company recorded a non-cash charge to operating earnings of \$106,833. This charge included approximately \$69,928 of goodwill and \$32,405 of property, plant and equipment related to the book business, primarily goodwill associated with the purchase of B. Dalton, other mall-bookstore assets and \$6,186 of warehouse equipment. The Company's small-format mall-based bookstores have experienced significant declines in sales and profitability as a result of increased competition from book superstores and Internet book retailers. In fiscal 2000, B. Dalton comparable store sales declined (1.7%) compared with an increase in comparable store sales of 0.1% in fiscal 1999. As a result, the anticipated future cash flows from certain stores were no longer sufficient to recover the carrying value of the underlying assets. Also, included in this charge were other charges of \$4,500 related to the write-off of certain investments which had continuing adverse financial results. The estimated fair value of the assets was based on anticipated future cash flows discounted at a rate commensurate with the risk involved.

17. Stock Option Plans

The Company grants options to purchase Barnes & Noble, Inc. (BKS) and GameStop Corp. (GME) common shares under the incentive plans discussed below. In accordance with SFAS No. 123, the Company discloses the pro forma impact of recording compensation expense utilizing the Black-Scholes model. The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the Black-Scholes model does not necessarily provide a reliable measure of the fair value of the companies' stock options. The pro forma effect on net income and earnings per share, had the Company applied the fair-value-recognition provisions of SFAS No. 123, is shown in Note 1.

BKS Stock Option Plans

The Company currently has two incentive plans under which stock options have been or may be granted to officers, directors and key employees of the Company, the 1991 Employee Incentive Plan (the 1991 Plan) and the 1996 Incentive Plan (the 1996 Plan). The options to purchase common shares generally are issued at fair market value on the date of the grant, begin vesting after one year in 33-1/3 percent or 25 percent increments per year, expire 10 years from issuance and are conditioned upon continual employment during the vesting period.

The 1996 Plan and the 1991 Plan allow the Company to grant options to purchase up to 14,500,000 and 4,732,704 shares of common stock, respectively. No more grants may be made under the 1991 Plan.

In addition to the two incentive plans, the Company has granted stock options to certain key executives and directors. The vesting terms and contractual lives of these grants are similar to that of the incentive plans.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

On July 24, 2002, Leonard Riggio, the Company's Chairman, entered into an Agreement with Stephen Riggio, the Company's Chief Executive Officer, which was approved by the Compensation Committee of the Company's Board of Directors. The Agreement granted Stephen Riggio options to direct Leonard Riggio to exercise certain stock options held by Leonard Riggio covering 2,000,000 shares of the Company's common stock. Upon any such exercise, Stephen Riggio would be entitled to the value of the underlying common stock to the extent it exceeds certain specified values, none of which is less than the quoted market price of the stock at the date of the Agreement. The Agreement was entered into in connection with Stephen Riggio's succeeding Leonard Riggio as the Company's Chief Executive Officer. The options have been accounted for under APB 25.

The weighted-average fair value of the options granted during fiscal 2002, 2001 and 2000 were estimated at \$8.96, \$10.13 and \$7.86, respectively, using the Black-Scholes option-pricing model with the following assumptions:

Fiscal Year	2002	2001	2000
Volatility	40%	35%	35%
Risk-free interest rate	3.51%	4.86%	6.50%
Expected life	6 years	6 years	6 years

A summary of the status of the Company's BKS stock options is presented below:

(Thousands of shares)	Shares	Weighted-Average Exercise Price
Balance, January 29, 2000	11,143	\$ 17.27
Granted	2,675	17.04
Exercised	(995)	13.64
Forfeited	(807)	22.76
Balance, February 3, 2001	12,016	17.15
Granted	2,204	18.24
Exercised	(2,163)	21.81
Forfeited	(362)	23.76
Balance, February 2, 2002	11,695	18.04
Granted	2,182	20.09
Exercised	(385)	18.52
Forfeited	(924)	20.22
Balance, February 1, 2003	12,568	\$ 18.22

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

The following table summarizes information as of February 1, 2003 concerning outstanding and exercisable options:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding (000s)	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number Exercisable (000s)	Weighted-Average Exercise Price
\$3.59	337	0.40	\$ 3.59	337	\$ 3.59
\$10.00 - \$16.75	5,374	2.22	\$ 13.18	4,475	\$ 12.46
\$17.13 - \$24.25	5,440	7.71	\$ 20.92	1,942	\$ 21.19
\$26.50 - \$34.75	1,417	6.32	\$ 30.52	793	\$ 30.96
\$3.59 - \$34.75	12,568	5.01	\$ 18.22	7,547	\$ 16.25

GME Stock Option Plans

In August 2001, the Company approved the 2001 Incentive Plan of GameStop Corp. (the 2001 Plan). The 2001 Plan assumed (by the issuance of replacement options) all stock options outstanding as of the effective date under the 2000 Incentive Plan of GameStop, Inc. (the 2000 Plan) under the same terms.

Effective September 13, 2000, the Company approved the 2000 Plan. The 2000 Plan provides a maximum aggregate amount of 15,000,000 shares of common stock with respect to which options may be granted and provides for the granting of incentive stock options, non-qualified stock options, and restricted stock, which may include, without limitation, restrictions on the right to vote such shares and restrictions on the right to receive dividends on such shares. The options to purchase common shares generally are issued at fair market value on the date of grant. Generally, the options vest and become exercisable ratably over a three-year period, commencing one year after the grant date, and expire ten years from issuance.

A summary of the status of the Company's GME stock options is presented below:

(Thousands of shares)	Shares	Weighted-Average Exercise Price
Balance, January 29, 2000	—	\$ —
Granted	4,488	3.53
Exercised	—	—
Forfeited	(18)	3.53
Balance, February 3, 2001	4,470	3.53
Granted	4,500	4.51
Exercised	—	—
Forfeited	(159)	3.53
Balance, February 2, 2002	8,811	4.03
Granted	4,545	18.02
Exercised	(287)	3.53
Forfeited	(309)	12.10
Balance, February 1, 2003	12,760	\$ 8.83

The following table summarizes information as of February 1, 2003 concerning outstanding and exercisable options:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding (000s)	Weighted- Average Remaining Contractual Life	Weighted- Average Exercise Price	Number Exercisable (000s)	Weighted- Average Exercise Price
\$3.53	3,898	7.84	\$ 3.53	2,525	\$ 3.53
\$4.51(1)	4,500(1)	8.36(1)	\$ 4.51(1)	4,500(1)	\$ 4.51(1)
\$16.48	15	9.43	\$16.48	—	\$ 16.48
\$18.00	4,317	9.06	\$18.00	—	\$ 18.00
\$21.25	30	9.31	\$21.25	—	\$ 21.25
\$3.53 - \$21.25	12,760	8.44	\$ 8.83	7,025	\$ 4.16

(1) These options are held by Leonard Riggio, the Company's Chairman of the Board and principal stockholder.

The weighted-average fair value of the options granted during the 52 weeks ended February 1, 2003, the 52 weeks ended February 2, 2002, and the 53 weeks ended February 3, 2001 were estimated at \$8.08, \$2.75 and \$1.60, respectively, using the Black-Scholes option pricing model with the following assumptions:

Fiscal Year	2002	2001	2000
Volatility	62%	61%	61%
Risk-free interest rate	4.60%	4.97%	5.56%
Expected life	6 years	6 years	6 years

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

18. Commitments and Contingencies

The Company leases retail stores, warehouse facilities, office space and equipment. Substantially all of the retail stores are leased under noncancelable agreements which expire at various dates through 2036 with various renewal options for additional periods. The agreements, which have been classified as operating leases, generally provide for both minimum and percentage rentals and require the Company to pay all insurance, taxes and other maintenance costs. Percentage rentals are based on sales performance in excess of specified minimums at various stores.

Rental expense under operating leases are as follows:

Fiscal Year	2002	2001	2000
Minimum rentals	\$370,746	358,522	338,922
Percentage rentals	15,404	14,274	10,782
	<u>\$386,150</u>	<u>372,796</u>	<u>349,704</u>

Future minimum annual rentals, excluding percentage rentals, required under leases that had initial, noncancelable lease terms greater than one year, as of February 1, 2003 are:

Fiscal Year	
2003	\$ 369,730
2004	339,622
2005	318,430
2006	294,286
2007	276,825
After 2007	1,283,225
	<u>\$2,882,118</u>

The Company leases one of its distribution facilities located in South Brunswick, New Jersey from the New Jersey Economic Development Authority (NJEDA) under the terms of an operating lease expiring in June 2011. Under the terms of this lease, the Company provides a residual value guarantee to the NJEDA, in an amount not to exceed \$5,000, relating to the fair market value of this distribution facility calculated at the conclusion of the lease term. The Company believes that the possibility that any such payment would be required under this guarantee is remote.

19. Legal Proceedings

In August 1998, The Intimate Bookshop, Inc. and its owner, Wallace Kuralt, filed a lawsuit in the United States District Court for the Southern District of New York against the Company, Borders Group, Inc. and others, alleging violation of the Robinson-Patman Act and other federal law, New York statutes governing trade practices and common law. In March 2000, a Second Amended Complaint was served on the Company and other defendants alleging a single cause of action for violations of the Robinson-Patman Act. The Second Amended Complaint claims that The Intimate Bookshop, Inc. has suffered damages of \$11,250 or more and requests treble damages, costs, attorneys' fees and interest, as well as

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

declaratory and injunctive relief prohibiting the defendants from violating the Robinson-Patman Act. The Company served an Answer in April 2000 denying the material allegations of the Second Amended Complaint and asserting various affirmative defenses. On January 11, 2002, the Company and the other defendants filed a motion for summary judgment. A hearing on that motion was held on March 22, 2002. The Company intends to vigorously defend this action.

On March 14, 2003, a Company employee filed a class action lawsuit against the Company in the Superior Court of California for the County of Orange (Case No. 03CC00088). The complaint alleges that the Company improperly classified the assistant store managers, department managers and receiving managers working in its California stores as salaried exempt employees. The complaint alleges that these employees spent more than 50 percent of their time performing non-exempt work and should have been classified as non-exempt employees. The complaint alleges violations of the California Labor Code and California Business and Professions Code and seeks relief, including unpaid overtime compensation, prejudgment interest, penalties, attorneys' fees and costs. The Company intends to vigorously defend this action, including contesting its certification as a class action.

In addition to the above actions, various claims and lawsuits arising in the normal course of business are pending against the Company. The subject matter of these proceedings primarily includes commercial disputes, personal injury claims and employment issues. The results of these proceedings are not expected to have a material adverse effect on the Company's consolidated financial position or results of operations.

20. Certain Relationships and Related Transactions

The Company believes that the transactions and agreements discussed below (including renewals of any existing agreements) between the Company and its affiliates are at least as favorable to the Company as could be obtained from unaffiliated parties. The Board of Directors and the Audit Committee are designated to approve in advance any new proposed transaction or agreement with affiliates and will utilize procedures in evaluating the terms and provisions of such proposed transaction or agreement as are appropriate in light of the fiduciary duties of directors under Delaware law.

The Company leases space for its executive offices in properties in which Leonard Riggio has a minority interest. The space was rented at an aggregate annual rent including real estate taxes of approximately \$4,043, \$3,966 and \$3,378 in fiscal years 2002, 2001 and 2000, respectively. Rent per square foot is approximately \$28.00, which is below market.

The Company leases a 75,000-square-foot office/warehouse from a partnership in which Leonard Riggio has a 50 percent interest, pursuant to a lease expiring in 2023. Pursuant to such lease, the Company paid \$752, \$490 and \$648 in fiscal years 2002, 2001 and 2000, respectively.

The Company leases retail space in a building in which Barnes & Noble College Bookstores, Inc. (B&N College), a company owned by Leonard Riggio, subleases space for its executive offices from the Company. Occupancy costs allocated by the Company to B&N College for this space totaled \$771, \$748 and \$709 for fiscal years 2002, 2001 and 2000, respectively. The amount paid by B&N College to the Company approximates the cost per square foot paid by the Company to its unaffiliated third-party landlord.

The Company subleased warehouse space from Barnes & Noble.com in Reno, Nevada. The Company paid Barnes & Noble.com \$279, \$1,838 and \$1,401 for such subleased space during fiscal 2002, 2001 and 2000, respectively. Additionally, in January 2001, the Company purchased \$6,186 of warehouse equipment (valued at original cost) from Barnes & Noble.com's Reno warehouse. In January

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

2002, Barnes & Noble.com determined it could not effectively utilize the full capacity of the Reno, Nevada distribution center. As a result, Barnes & Noble.com's Board of Directors approved the transfer of the Reno warehouse lease and the sale of inventory located in Reno to the Company. The Company purchased the inventory from Barnes & Noble.com at cost for \$9,877. In addition, the Company spent \$1,755 to refurbish the facility. The Company's Board of Directors also approved the Company's assumption of the lease, which expires in 2010, and the hiring of all of the employees at the Reno facility. The Reno lease assignment and the transfer of the Reno facility to the Company was completed in April 2002. The Company intends to use the Reno facility to facilitate distribution to its current and future West Coast stores. In connection with the transition, Barnes & Noble.com agreed to pay one-half of the rent for the Reno facility through December 31, 2002. Barnes & Noble.com paid \$905 in relation to these expenses for fiscal year 2002.

The Company subleases to Barnes & Noble.com approximately one-third of a 300,000-square-foot warehouse facility located in New Jersey. The Company has received from Barnes & Noble.com \$498, \$479 and \$489 for such subleased space during fiscal 2002, 2001 and 2000, respectively. The amount paid by Barnes & Noble.com to the Company approximates the cost per square foot paid by the Company as a tenant pursuant to the lease of the space from an unaffiliated third party.

The Company has entered into an agreement (the Supply Agreement) with Barnes & Noble.com whereby the Company charges Barnes & Noble.com the costs associated with such purchases plus incremental overhead incurred by the Company in connection with providing such inventory. The Supply Agreement is subject to certain termination provisions. Barnes & Noble.com purchased \$108,269, \$119,290 and \$110,462 of merchandise from the Company during fiscal 2002, 2001 and 2000, respectively, and Barnes & Noble.com expects to source purchases through the Company in the future.

The Company has entered into agreements whereby Barnes & Noble.com receives various services from the Company, including, among others, services for payroll processing, benefits administration, insurance (property, casualty, medical, dental, life, etc.), tax, traffic, fulfillment and telecommunications. In accordance with the terms of such agreements, the Company has received, and expects to continue to receive, fees in an amount equal to the direct costs plus incremental expenses associated with providing such services. The Company received \$3,453, \$5,465 and \$1,699 for such services during fiscal 2002, 2001 and 2000, respectively.

The aggregate receivable (which is historically settled within 60 days) from Barnes & Noble.com in connection with the agreements described above was \$55,174 and \$47,204 as of February 1, 2003 and February 2, 2002, respectively.

The Company and Barnes & Noble.com commenced a marketing program in November 2000, whereby a customer purchases a "Readers' Advantage™ card" for an annual membership fee of \$25.00 which is non-refundable after the first 30 days of the membership term. With this card, customers can receive discounts of 10 percent on all Company purchases and 5 percent on all Barnes & Noble.com purchases. The Company and Barnes & Noble.com have agreed to share the expenses, net of revenue from the sale of the cards, related to this program in proportion to the discounts customers receive on purchases with each company.

In 2002, the Company through its wholly owned subsidiary, Marketing Services (Minnesota) Corp., entered into an agreement with Barnes & Noble.com for marketing services, which includes the issuance of gift cards. Under this agreement, the Company paid Barnes & Noble.com \$5,273 during fiscal 2002, which represents reimbursement for gift cards purchased in a Barnes & Noble store and redeemed on the Barnes & Noble.com Web site.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

Barnes & Noble.com, through its fulfillment centers, ships various customer orders for the Company to its retail stores as well as to the Company's customers' homes. Barnes & Noble.com charges the Company the costs associated with such shipments plus any incremental overhead incurred by Barnes & Noble.com to process these orders. The Company paid Barnes & Noble.com \$1,746, \$1,030 and \$222 for shipping and handling during fiscal 2002, 2001 and 2000, respectively. In addition, during fiscal 2001, the Company and Barnes & Noble.com reached an agreement whereby the Company pays a commission on all items ordered by customers at the Company's stores and shipped directly to customers' homes by Barnes & Noble.com. Commissions paid for these sales were \$1,547 and \$359 during fiscal 2002 and 2001, respectively.

The Company paid B&N College certain operating costs B&N College incurred on the Company's behalf. These charges are included in the accompanying consolidated statements of operations and approximated \$219, \$188 and \$264 for fiscal 2002, 2001 and 2000, respectively. B&N College purchased inventory, at cost plus an incremental fee, of \$44,944, \$41,452 and \$17,198 from the Company during fiscal 2002, 2001 and 2000, respectively. The Company charged B&N College \$2,064, \$1,517 and \$1,331 for fiscal years 2002, 2001 and 2000, respectively, for capital expenditures, business insurance and other operating costs incurred on its behalf.

The Company uses a jet aircraft owned by B&N College and pays for the costs and expenses of operating the aircraft based upon the Company's usage. Such costs which include fuel, insurance, personnel and other costs approximated \$1,872, \$2,228 and \$2,401 during fiscal 2002, 2001 and 2000, respectively, and are included in the accompanying consolidated statements of operations.

In fiscal 1999, the Company acquired Babbage's Etc., one of the nation's largest video-game and entertainment-software specialty retailers, a company majority owned by Leonard Riggio, for \$208,670. An independent Special Committee of the Board of Directors negotiated and approved the acquisition on behalf of the Company. The Company made an additional payment of \$9,665 in fiscal 2002 due to certain financial performance targets having been met during fiscal 2001. In fiscal 2000, the Company acquired Funco, Inc. Through a corporate restructuring, Babbage's Etc. became a wholly owned subsidiary of Funco, Inc. and the name of Funco, Inc. was changed to GameStop, Inc. In fiscal 2002, the Company completed an initial public offering of its GameStop subsidiary. The Company retained an approximate 63 percent interest in GameStop.

GameStop operates departments within some of the Company's bookstores. GameStop pays a license fee to the Company in an amount equal to 7 percent of the gross sales of such departments. The Company charged GameStop a license fee of \$1,103 in fiscal 2002. GameStop participates in the Company's worker's compensation, property and general liability insurance programs. The costs incurred by the Company under these programs are allocated to GameStop based upon GameStop's total payroll expense, property and equipment, and insurance claim history. During fiscal 2002, these charges amounted to \$1,726.

In fiscal 2001, Barnes & Noble.com and GameStop entered into an agreement whereby Barnes & Noble.com's Web site refers customers to the GameStop Web site for purchases of video-game hardware, software and accessories and PC-entertainment software. GameStop pays Barnes & Noble.com a referral fee based on its net sales revenue from certain eligible purchases made by customers as a result of the redirection from the Barnes & Noble.com Web site. Either party may terminate the agreement on 60 days' notice. Commissions were \$14 and \$89 for fiscal years 2002 and 2001, respectively.

The Company is provided with national freight distribution, including trucking, services by the LTA Group, Inc. (LTA), a company in which a brother of Leonard Riggio owns a 20 percent interest.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

The Company paid LTA \$18,509, \$17,746 and \$16,661 for such services during fiscal years 2002, 2001 and 2000, respectively. The Company believes the cost of freight delivered to the stores compares favorably to the prices charged by publishers and other third-party freight distributors.

Since 1993, the Company has used AEC One Stop Group, Inc. (AEC) as its primary music and DVD/video supplier and to provide a music and video database. AEC is one of the largest wholesale distributors of music and DVD/videos in the United States. In 1999, AEC's parent corporation was acquired by an investor group in which Leonard Riggio was a minority investor. The Company paid AEC \$246,409, \$169,879 and \$160,788 for merchandise purchased during fiscal 2002, 2001 and 2000, respectively. In addition, the Company paid AEC \$7,736, \$2,554 and \$527 for database equipment and services during fiscal 2002, 2001 and 2000, respectively. Amounts payable to AEC for merchandise purchased were \$21,967 and \$51,121 as of February 1, 2003 and February 2, 2002, respectively.

21. Selected Quarterly Financial Information (Unaudited)

A summary of quarterly financial information for each of the last two fiscal years is as follows:

Fiscal 2002 Quarter End On or About	April 2002	July 2002	October 2002	January 2003	Total Fiscal Year 2002
Sales	\$1,133,126	1,159,214	1,130,885	1,846,110	5,269,335
Gross profit	\$ 283,633	302,055	293,917	533,888	1,413,493
Equity in net loss of Barnes & Noble.com (a)	\$ (7,435)	(7,469)	(6,323)	(5,568)	(26,795)
Net earnings (loss)	\$ (16,321)	1,429	3,829	111,011	99,948
Earnings (loss) per common share					
Basic	\$ (0.25)	0.02	0.06	1.72	1.51
Diluted	\$ (0.25)	0.02	0.05	1.49	1.39

Fiscal 2001 Quarter End On or About	April 2001	July 2001	October 2001	January 2002	Total Fiscal Year 2001
Sales	\$1,009,637	1,050,018	995,605	1,815,130	4,870,390
Gross profit	\$ 259,051	275,322	261,794	514,185	1,310,352
Equity in net loss of Barnes & Noble.com (a)	\$ (14,315)	(13,906)	(13,865)	(46,292)	(88,378)
Net earnings (loss)	\$ (11,492)	(1,690)	(6,806)	83,955	63,967
Earnings (loss) per common share					
Basic	\$ (0.18)	(0.03)	(0.10)	1.25	0.96
Diluted	\$ (0.18)	(0.03)	(0.10)	1.09	0.94

(a) Based on varying ownership interests as more fully discussed in Note 8 of the Notes to Consolidated Financial Statements.

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

The Board of Directors
Barnes & Noble, Inc.

We have audited the accompanying consolidated balance sheets of Barnes & Noble, Inc. and subsidiaries as of February 1, 2003 and February 2, 2002 and the related consolidated statements of operations, changes in shareholders' equity and cash flows for each of the three fiscal years in the period ended February 1, 2003. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Barnes & Noble, Inc. and its subsidiaries as of February 1, 2003 and February 2, 2002 and the results of their operations and their cash flows for each of the three fiscal years in the period ended February 1, 2003, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the Consolidated Financial Statements, effective February 3, 2002, the Company adopted Statement of Financial Standards No. 142, *Goodwill and Other Intangible Assets*.

New York, New York
March 14, 2003

/s/BDO Seidman, LLP

BDO Seidman, LLP

Exhibit 21.1

Subsidiaries of Barnes & Noble, Inc.

1. Barnes & Noble Booksellers, Inc., a Delaware corporation that operates its retail bookstores directly and through seven wholly owned United States subsidiaries.
2. B. Dalton Bookseller, Inc., a Minnesota corporation.
3. Doubleday Book Shops, Inc., a Delaware corporation.
4. B&N GameStop Holding Corp., a Delaware corporation.
5. GameStop Corp., a Delaware corporation.
6. GameStop, Inc., a Minnesota corporation.
7. Babbage's Etc. LLC, a Delaware limited liability company.
8. Sunrise Publications, Inc., a Minnesota corporation.
9. B&N.com Holding Corp., a Delaware corporation.
10. Barnes & Noble Publishing, Inc., a Delaware corporation that operates its book publishing business directly and through two wholly owned United States subsidiaries.
11. CCI Holdings, Inc., a Texas corporation.
12. Calendar Club L.L.C., a Delaware limited liability company.
13. Sterling Publishing Co., Inc., a New York corporation.
14. Altamont Press, Inc., a North Carolina corporation.
15. Marketing Services (Minnesota) Corp., a Minnesota corporation.
16. Barnes & Noble Services, Inc., a New York corporation.
17. Marboro Books Corp., a New York corporation.

Exhibit 23.1

CONSENT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Barnes & Noble, Inc.
New York, New York

We hereby consent to the incorporation by reference of our report dated March 14, 2003 relating to the consolidated financial statements of Barnes & Noble, Inc. and subsidiaries, incorporated by reference into the Company's Annual Report on Form 10-K for the year ended February 1, 2003, into the prospectuses constituting a part of the following registration statements: No. 33-84826 on Form S-3, No. 33-89258 on Form S-3, No. 33-270333 on Form S-8, No. 33-89260 on Form S-8, and No. 33-97410 on Form S-3.

We also consent to the references to us under the caption "Experts" in the Prospectuses.

BDO Seidman, LLP
New York, New York
April 23, 2003

Exhibit 23.2

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

The Board of Directors
Barnes & Noble, Inc.

The audits referred to in our report dated March 14, 2003 relating to the consolidated financial statements of Barnes & Noble, Inc. and subsidiaries which is incorporated in Item 8 of the Form 10-K by reference to the annual report to stockholders for the year ended February 1, 2003 included the audit of the financial statement schedules listed in the accompanying index. These financial statement schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statement schedules based upon our audits.

In our opinion such financial statement schedules present fairly, in all material respects, the information set forth therein.

BDO Seidman, LLP

New York, New York

April 23, 2003

Exhibit 99.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the annual report of Barnes & Noble, Inc. (the "Company") on Form 10-K for the period ended February 1, 2003 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Stephen Riggio, Chief Executive Officer of the Company, certify, to the best of my knowledge, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Stephen Riggio

Stephen Riggio
Chief Executive Officer
Barnes & Noble, Inc.
April 23, 2003

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

Exhibit 99.2

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the annual report of Barnes & Noble, Inc. (the "Company") on Form 10-K for the period ended February 1, 2003 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Lawrence S. Zilavy, Chief Financial Officer of the Company, certify, to the best of my knowledge, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Lawrence S. Zilavy

Lawrence S. Zilavy
Chief Financial Officer
Barnes & Noble, Inc.
April 23, 2003

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.