

BJS WHOLESALE CLUB INC  
Form 10-K  
April 13, 2006

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**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-K**

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF

THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended January 28, 2006

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

Commission File Number 001-13143

**BJ S WHOLESALE CLUB, INC.**

(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction  
of incorporation or organization)

04-3360747  
(I.R.S. Employer  
Identification No.)

One Mercer Road  
Natick, Massachusetts  
(Address of principal executive offices)

01760  
(Zip Code)

Registrant's telephone number, including area code: (508) 651-7400

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

| Title of each class             | Name of each exchange<br>on which registered |
|---------------------------------|--|
| Common Stock, par value \$.01   | New York Stock Exchange                      |
| Preferred Share Purchase Rights | New York Stock Exchange                      |

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

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

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

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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 the Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer  Accelerated filer  Non-accelerated filer   
Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

The aggregate market value of the voting stock held by non-affiliates of the Registrant on July 29, 2005 was approximately \$2,166,290,000 based on the closing price of \$31.89 on the New York Stock Exchange as of such date.

There were 67,466,123 shares of the Registrant's Common Stock, \$.01 par value, outstanding as of March 24, 2006.

### Documents Incorporated by Reference

Portions of the Proxy Statement for the Registrant's 2006 Annual Meeting of Stockholders (Part III).

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**INFORMATION RELATING TO FORWARD-LOOKING STATEMENTS**

In this report, BJS Wholesale Club, Inc. may be referred to as BJS or the Company or we.

This report contains a number of forward-looking statements, including statements regarding the increase in membership fees, planned capital expenditures, planned club, gas station and cross-dock facility openings, expected provision for income taxes, BJS's reserve for credit and debit card claims, lease obligations in connection with a closed BJS club, ProFoods, the effects of implementing SFAS 123(R), sales penetration of private label products and other information with respect to our plans and strategies. Any statements contained herein that are not statements of historical fact may be deemed to be forward-looking statements. Without limiting the foregoing, the words believes, intends, anticipates, plans, estimates, expects and similar expressions are intended to identify forward-looking statements. There are a number of important factors that could cause actual events or our actual results to differ materially from those indicated by such forward-looking statements, including, without limitation, the factors set forth in Item 1A. Risk Factors, and other factors noted elsewhere in this Management's Discussion and Analysis of Financial Condition and Results of Operations, particularly those noted under Critical Accounting Policies and Estimates. In addition, any forward-looking statements represent our estimates only as of the day this annual report was first filed with the Securities and Exchange Commission and should not be relied upon as representing our estimates as of any subsequent date. While we may elect to update forward-looking statements at some point in the future, we specifically disclaim any obligation to do so, even if our estimates change.

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**PART I**
**Item 1. Business***General*

BJ's Wholesale Club introduced the warehouse club concept to New England in 1984 and has since expanded to become a leading warehouse club operator in the eastern United States. As of January 28, 2006, BJ's operated 165 warehouse clubs, including two ProFoods Restaurant Supply clubs, in 16 states. The table below shows the number of Company locations by state.

| <u>State</u>   | <u>Number of<br/>Locations</u> |
|----------------|--------------------------------|
| New York       | 34                             |
| Florida        | 23                             |
| Massachusetts  | 18                             |
| New Jersey     | 18                             |
| Pennsylvania   | 13                             |
| Maryland       | 9                              |
| Connecticut    | 8                              |
| Georgia        | 8                              |
| North Carolina | 7                              |
| Virginia       | 7                              |
| New Hampshire  | 6                              |
| Ohio           | 6                              |
| Rhode Island   | 3                              |
| Maine          | 2                              |
| Delaware       | 2                              |
| South Carolina | 1                              |
| <b>TOTAL</b>   | <b>165</b>                     |

On July 28, 1997, BJ's Wholesale Club, Inc., a Delaware corporation, became an independent, publicly owned entity when Waban Inc. ( "Waban" ), BJ's parent company at the time, distributed to its stockholders on a pro rata basis all of the Company's outstanding common stock. Before that date, BJ's business had operated as a division of Waban.

The fiscal year ended January 28, 2006 is referred to as "2005" or "fiscal 2005" below. Other fiscal years are referred to in a similar manner.

*Industry Overview*

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Warehouse clubs offer a narrow assortment of food and general merchandise items within a wide range of product categories. In order to achieve high sales volumes and rapid inventory turnover, merchandise selections are generally limited to items that are brand name leaders in their categories and a growing private brands assortment. Since warehouse clubs sell a diversified selection of product categories, they attract customers from a wide range of other wholesale and retail distribution channels, such as supermarkets, supercenters, department stores, drug stores, discount stores, office supply stores, consumer electronics stores and automotive stores. BJS believes that it is difficult for these higher cost channels of distribution to match the low prices offered by warehouse clubs.

Warehouse clubs eliminate many of the merchandise handling costs associated with traditional multiple-step distribution channels by purchasing full truckloads of merchandise directly from manufacturers and by storing merchandise on the sales floor rather than in central warehouses. By operating no-frills, self-service warehouse

facilities, warehouse clubs have fixturing and operating costs substantially below those of traditional retailers. Because of their higher sales volumes and rapid inventory turnover, warehouse clubs generate cash from the sale of a large portion of their inventory before they are required to pay merchandise vendors. As a result, a greater percentage of the inventory is financed through vendor payment terms than by working capital. Two broad groups of customers, individual households and small businesses, have been attracted to the savings made possible by the high sales volumes and operating efficiencies achieved by warehouse clubs. Customers at warehouse clubs are generally limited to members who pay an annual fee.

*Business Model*

We have developed an operating model that we believe differentiates us from our warehouse club competition. First, we place added focus on the individual consumer, our Inner Circle® member, through merchandising strategies that emphasize a customer-friendly shopping experience. Second, by clustering our clubs, we achieve the benefit of name recognition and maximize the efficiencies of our management support, distribution and marketing activities. Finally, we seek to establish and maintain the first or second industry leading position in each major market where we operate. We create an exciting shopping experience for our members with a constantly changing mix of food and general merchandise items and carry a broader product assortment than our warehouse club competitors. By supplementing the warehouse format with aisle markers, express checkout lanes, self-checkout lanes and low-cost video-based sales aids, we make shopping more efficient for our members. For the convenience of our members, we maintain longer hours of operation than our warehouse club competitors. While all wholesale clubs sell merchandise in bulk, BJ's also offers smaller package sizes that are easier to carry home and store, including sizes that are comparable to those offered in supermarkets. Smaller package sizes can be found in a number of our fresh food categories, including dairy, meat, bakery, fish and produce. We are also the only major warehouse club operator to accept manufacturers' coupons, which provide added value for our members, and we accept more credit card payment options than our warehouse club competitors.

*Expansion*

Since the beginning of 2000, BJ's has grown from 107 clubs to 165 clubs in operation at January 28, 2006. Approximately 37% of our clubs have been in operation for fewer than six years. We plan to open 12 to 15 new clubs in 2006, all of which are expected to be in existing markets.

| <b>Year</b> | <b>Clubs<br/>in Operation<br/>at Beginning<br/>of Year</b> | <b>Clubs<br/>Opened<br/>During<br/>the Year</b> | <b>Clubs<br/>Closed<br/>During<br/>the Year</b> | <b>Clubs<br/>in Operation<br/>at End<br/>of Year</b> |
|-------------|--|---|---|--|
| 2000        | 107  | 11  |   | 118  |
| 2001        | 118  | 12  |   | 130  |
| 2002        | 130  | 13  | 3   | 140  |
| 2003        | 140  | 10  |   | 150  |
| 2004        | 150  | 7   |   | 157  |
| 2005        | 157  | 8   |   | 165  |

In addition to the club openings shown above, we relocated one club in each of 2000, 2001 and 2005. In each case, we replaced an older club with a new prototype.

*Store Profile*

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As of January 28, 2006, we operated 144 traditional size big box warehouse clubs that averaged approximately 112,000 square feet, 19 smaller format warehouse clubs that averaged approximately 71,000 square feet and two ProFoods clubs that averaged approximately 62,000 square feet. The smaller format clubs are designed to serve markets whose population is not sufficient to support a full-sized warehouse club. Including space for parking, a typical full-sized BJ's club requires 13 to 14 acres of land. The smaller version typically requires approximately eight acres. Our clubs are located in both free-standing locations and shopping centers.

Construction and site development costs for a full-sized owned BJ's club generally range from \$5 million to \$8 million. Land acquisition costs for a club generally range from \$5 million to \$10 million but can be significantly higher in some locations. We also invest \$3 to \$4 million for fixtures and equipment and approximately \$2 million for inventory (net of accounts payable) and incur approximately \$.9 to \$1.0 million for preopening costs in a new full-sized club.

### *Merchandising*

We service our existing members and attract new members by providing a broad range of high quality, brand name merchandise at prices that are consistently lower than the prices of traditional retailers, including discount retailers, supermarkets, supercenters and specialty retail operations. We limit the items offered in each product line to fast selling styles, sizes and colors, carrying an average of approximately 7,500 active stockkeeping units (SKU's). By contrast, supermarkets normally stock from 30,000 to 52,000 SKU's, and supercenters typically stock up to 125,000 SKU's. We work closely with manufacturers to develop packaging and sizes which are best suited to selling through the warehouse club format in order to minimize handling costs and to provide increased value to members.

Food accounted for approximately 59% of BJ's total food and general merchandise sales in 2005. The remaining 41% consisted of a wide variety of general merchandise items. Food categories at BJ's include frozen foods, fresh meat and dairy products, beverages, dry grocery items, fresh produce and flowers, canned goods and household paper products. In response to growing demand from our members, we continue to increase the number of clubs that have rotisserie chicken and slicing delicatessen departments and premium prepared foods. General merchandise includes consumer electronics, prerecorded media, small appliances, tires, jewelry, health and beauty aids, household needs, computer software, books, greeting cards, apparel, furniture, toys and seasonal items. We believe that more than 70% of our products are items that can also be found in supermarkets.

We continued to expand our private brands program during 2005. BJ's consumer-focused private brand products are primarily premium quality and generally are priced well below the top branded competing product. At the end of 2005, our private brand products had achieved a sales penetration of approximately 12% of food and general merchandise sales on an annualized basis. We expect our private brand products to continue to represent an increasing percentage of sales over time.

As of January 28, 2006, we had pharmacies in operation at 44 of our clubs. We plan to open pharmacies in two or three additional clubs in 2006.

We also offer a number of specialty services that are designed to enable members to complete more of their shopping at BJ's and to encourage more frequent trips to the clubs. Most of these services are provided by outside operators in space leased from BJ's. Specialty services include full-service optical centers; food courts, some of which offer brand name fast food service; full service Verizon Wireless centers; home improvement services; photo developing; BJ's Vacation<sup>®</sup>; garden and storage sheds; patios and sunrooms; a propane tank filling service; discounted home heating oil; and muffler and brake services operated in conjunction with Monro Muffler Brake, Inc.

As of January 28, 2006, we had 87 gas stations in operation at our clubs. The gas stations are generally self-service, relying on pay at the pump technology that accepts MasterCard<sup>®</sup>, VISA<sup>®</sup>, Discover<sup>®</sup>, American Express<sup>®</sup> and debit card transactions. Cash is also accepted at some locations. Both regular and premium gasoline are available. We have generally maintained our gas prices below the average prices in each market.

Our BJ's Premier Benefits program is designed to enhance the value of BJ's membership to both consumer and business members. Included in the program are discounted rates for payment processing of all major credit cards; an automobile buying service; printing of business forms and



checks; and installation of home security systems.

### *Membership*

Paid membership is an essential part of the warehouse club concept. In addition to providing a source of revenue which permits us to offer low prices, membership reinforces customer loyalty. We have two types of members: Inner Circle members and business members. Most of our Inner Circle members are likely to be home owners whose incomes are above the average for the Company's trading areas. We believe that a significant percentage of our business members also shops BJ's for their personal needs. We had approximately 8.6 million BJ's members (including supplemental cardholders) at January 28, 2006.

Effective January 1, 2006, we generally charge \$45 per year for a primary Inner Circle membership that includes one free supplemental membership. Members in the same household may purchase additional supplemental memberships for \$20 each. A business membership also costs \$45 per year and includes one free supplemental membership. Additional supplemental business memberships cost \$20 each.

We launched our BJ's Rewards Membership<sup>SM</sup> program in 2003. Geared to high frequency, high volume members, the program offers a 2% rebate, capped at \$500 per year, on generally all in-club purchases. Effective January 1, 2006, the annual fee for a BJ's Rewards Membership is \$80. At the end of 2005, Rewards Members accounted for approximately 5% of our primary members and approximately 10% of our food and general merchandise sales during the year.

### *Advertising and Public Relations*

We increase customer awareness of our clubs primarily through direct mail, public relations efforts, new club marketing programs, and, during the holiday season, television and radio advertising (some of which is vendor funded) and the *BJ's Journal*, a publication sent to our members throughout the year. We also employ dedicated marketing personnel who solicit potential business members and who contact other selected organizations to increase the number of members. From time to time, we run free trial membership promotions to attract new members, with the objective of converting them to paid membership status, and also use one-day passes to introduce non-members to our clubs. These programs result in very low marketing expenses compared with typical retailers.

### *Club Operations*

Our ability to achieve profitable operations depends upon high sales volumes and the efficient operation of our warehouse clubs. We buy most of our merchandise from manufacturers for shipment either to a BJ's cross-dock facility or directly to our clubs. This eliminates many of the costs associated with traditional multiple-step distribution channels, including distributors' commissions and the costs of storing merchandise in central distribution facilities.

We route the majority of our purchases through cross-dock facilities which break down truckload quantity shipments from manufacturers and reallocate these goods for shipment to individual clubs, generally within 24 hours. Our efficient distribution systems result in reduced freight expenses and lower receiving costs.

We work closely with manufacturers to minimize the amount of handling required once merchandise is received at a club. Most merchandise is pre-marked by the manufacturer so that it does not require ticketing at the club. Merchandise for sale is generally displayed on pallets containing large quantities of each item, thereby reducing labor required for handling, stocking and restocking. Back-up merchandise is generally stored in

steel racks above the sales floor.

We have been able to limit inventory shrinkage to levels well below those typical of other retailers by strictly controlling the exits of our clubs, by generally limiting customers to members and by using state-of-the-art electronic article surveillance technology. Our inventory shrinkage was no more than .20% of net sales in each of the last five fiscal years. Problems associated with payments by check have been insignificant, as members who issue dishonored checks are restricted to cash-only terms. Our policy is to accept returns of most merchandise within 30 days after purchase.

BJ's is the only warehouse club operator to accept each of MasterCard, VISA, Discover and American Express chainwide. Our members may also pay for their purchases by cash, check and debit cards.

BJ's has a co-branded MasterCard which is underwritten by a major financial institution on a non-recourse basis. Purchases made at BJ's with the co-branded MasterCard earn a 1.5% rebate. All other purchases with the BJ's MasterCard earn rebates ranging from 0.5% to 1.0%. Rebates up to \$500 per year per membership account are issued by the financial institution in the form of BJ's Buck<sup>®</sup> certificates redeemable for merchandise at any BJ's club.

#### *Information Technology*

Over the course of our development, we have made a significant investment in information systems. We were the first warehouse club operator to introduce scanning devices which work in conjunction with our electronic point of sale terminals. In recent years, we have enhanced the efficiency of our checkout process and implemented an on-line refund system at the clubs to more effectively process sales returns. We are the only operator in the warehouse club industry to offer self-checkout. As of January 28, 2006, we have expanded this technology to approximately 75% of our BJ's clubs.

Sales data is generally analyzed daily for replenishment purposes. Detailed purchasing data permits the buying staff and store managers to track changes in members' buying behavior. Detailed shrinkage information by SKU by club allows management to quickly identify inventory shrinkage problems and formulate effective action plans.

#### *Member Centric Business Model*

Over the last three years we have developed an infrastructure, which we call Member Insight, to better utilize our member data base. We are using Member Insight's sophisticated analysis to segment our members according to their shopping behaviors in our clubs as well as in competing channels. This capability enables us to tailor BJ's merchandise selection, adjacencies, pricing and marketing to the wants and needs of our most productive members.

#### *Competition*

We compete with a wide range of national, regional and local retailers and wholesalers selling food and/or general merchandise in our markets, including supermarkets, supercenters, general merchandise chains, specialty chains, gasoline stations and other warehouse clubs, some of which have significantly greater financial and marketing resources than BJ's. Major competitors that operate warehouse clubs include Costco Wholesale Corporation and Sam's Clubs (a division of Wal-Mart Stores, Inc.), each of which operates on a nationwide basis.

A large number of competitive membership warehouse clubs exists in our markets. Approximately 83% of our 144 full-sized warehouse clubs have at least one competitive membership warehouse club in their trading areas at a distance of about ten miles or less. One of the smaller format clubs has direct competition from other warehouse clubs within ten miles.

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We believe price is the major competitive factor in the markets in which we compete. Other competitive factors include store location, merchandise selection, member services and name recognition. We believe our efficient, low-cost form of distribution gives us a significant competitive advantage over more traditional channels of wholesale and retail distribution.

### *ProFoods*

In October 2004, we began testing a concept that is new to BJs by opening the first of two new clubs in the Metro New York market exclusively for food service businesses under the name ProFoods Restaurant Supply. Our second ProFoods club, which is also in Metro New York, was opened in January 2005. The target members are professional food vendors and restaurant owners. The business model for ProFoods is built on somewhat

higher merchandise margins than those generated by a wholesale club, free memberships and a broad merchandise assortment to support one-stop shopping, primarily on a cash and carry basis. We believe that we can leverage our success as a highly efficient operator of limited assortment formats that cater to defined customer groups. We have embarked on this test because we believe there is a substantial opportunity in this market, where the competition is fragmented and where we can apply our expertise with small businesses.

#### *Seasonality*

Our business, in common with the business of retailers generally, is subject to seasonal influences. Our sales and net income have typically been strongest in the fourth quarter holiday season and lowest in the first quarter of each fiscal year.

#### *Employees*

As of January 28, 2006, we had approximately 20,300 full-time and part-time employees ( team members ). None of our team members is represented by a union. We consider our relations with our team members to be excellent.

#### *Available Information*

BJ s makes available free of charge on its Internet website its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as soon as reasonably practicable after such material is electronically filed with the Securities and Exchange Commission ( SEC ). Internet users can access this information on BJ s website at <http://www.bjs.com>.

You may read and copy any reports, statements or other information that we file with the SEC at the SEC s Public Reference Room at 100 F Street, N.E., Washington D.C. 20549. You can request copies of these documents, upon payment of a duplicating fee, by writing to the Securities and Exchange Commission. Please call the SEC at 1-800-SEC-0330 for further information on the operation of the Public Reference Room.

BJ s intends to post on its website all disclosures that are required by law or NYSE listing standards concerning any amendments to, or waivers from, any provision of the BJ s Statement on Commercial Bribery, Conflicts of Interest and Business Ethics.

#### *Certifications*

The Company s Chief Executive Officer and Chief Financial Officer have provided the certification required by Rule 13a-14(a) under the Exchange Act, copies of which are filed as exhibits to this Form 10-K. In addition, an annual Chief Executive Officer certification was submitted by the Company s Chief Executive Officer to the New York Stock Exchange on June 7, 2005, in accordance with the New York Stock Exchange s listing requirements.

**Item 1A. Risk Factors**

The risk factors that appear below could materially affect our business, financial condition and results of operations. The risks and uncertainties described below are those that we have identified as material, but are not the only risks and uncertainties facing us. Our business is also subject to general risks and uncertainties that affect many other companies, such as overall economic and industry conditions, especially in the Eastern United States where most of our clubs are located, geopolitical events, changes in laws or accounting rules, terrorism, major health concerns or other disruptions of expected economic or business conditions. Additional risks and uncertainties not currently known to us or that we currently believe are not material also may impair our business, results of operations and financial condition.

*Competition May Adversely Affect Our Profitability*

We compete with a wide range of national, regional and local retailers and wholesalers selling food and/or general merchandise in our markets. Some of these competitors, including two major warehouse club competitors (Sam's Clubs (a division of Wal-Mart Stores, Inc.) and Costco Wholesale Corporation) who operate on a nationwide basis, have significantly greater financial and marketing resources than BJs. These retailers and wholesalers compete in a variety of ways, including price, location, services offered to customers and merchandise selection. We cannot assure you that we will be able to compete successfully with existing or future competitors. Our inability to respond effectively to competitive factors may have an adverse effect on our profitability as a result of lower sales and increased operating costs.

*New Store Openings are Critical to Our Growth*

Our long-term sales and income growth are dependent to a certain degree on our ability to open new clubs and gasoline stations in both existing markets and new markets. We cannot assure you that we will be able to achieve our planned expansion on a timely and profitable basis. Our expansion is dependent on finding suitable locations, which may be affected by local regulations, construction and development costs and competition from other retailers for particular sites. In addition, we may not be able to hire, train and retain a suitable work force to staff these locations or successfully integrate new clubs into our existing infrastructure. As a result, we may be unable to open new clubs at the rates expected or operate the clubs in a profitable manner.

*Our Comparable Club Sales and Quarterly Operating Results May Fluctuate Significantly*

Our comparable club sales may be adversely affected for many reasons, including new store openings by our competitors and the opening of our own new clubs that may cannibalize existing club sales. Comparable club sales may also be affected by cycling against strong sales in the prior year, by our own clubs entering into the comparable club base and by price reductions in response to competition.

Our quarterly operating results may be adversely affected by losses in new clubs, price changes in response to competitors' prices, increases in operating costs, extreme weather conditions, natural disasters, local economic conditions and the timing of new club openings and related start-up costs. Our quarterly operating results may also be affected by the volatility in gasoline and energy prices. As a result, our quarterly operating results are not necessarily indicative of the results to be expected for any other quarter.

*Our Business May be Affected by Issues that Affect Consumer Spending*

Our results of operations may be affected by changes in economic factors that impact consumer spending. Certain economic conditions such as changes in inflation, unemployment levels, tax rates, interest rates, energy and transportation costs, insurance and health care costs and labor costs could reduce consumer spending or cause consumers to shift their spending to our competitors. Reduced consumer spending may result in reduced demand for our items and may also require increased selling and promotional expenses. A reduction or shift in consumer spending could negatively impact our business, results of operations and financial condition.

*Certain Legal Proceedings Could Adversely Impact Our Results of Operations*



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We are involved in a number of legal proceedings involving employment issues, personal injury, consumer matters, credit card fraud and other litigation. Certain of these lawsuits, if decided adversely to us or settled by us, may result in material liability. See Item 3. Legal Proceedings and Note F in Notes to Consolidated Financial Statements for additional information.

### *Union Attempts to Organize Our Team Members Could Disrupt Our Business*

Unions have attempted to organize our team members at certain of our clubs and facilities. Our management and team members may be required to devote their time to respond to union activities, which could be distracting to our operations. Future union activities may negatively impact our business and results of operations.

*Insurance Claims Could Adversely Impact our Results of Operations*

We use a combination of insurance and self-insurance plans to provide for potential liability for workers' compensation, general liability, property, fiduciary liability and employee health care and life insurance claims. Liabilities associated with risk retained by the Company are estimated, based on valuation provided by third-party actuaries, historical loss development factors and other assumptions believed to be reasonable under the circumstances. Our results of operations could be adversely impacted if actual future occurrences and claims differ from our assumptions and historical trends.

*Tax-Free Treatment of 1997 Spin-off from Waban May Be Affected by Future Events*

In connection with BJ's spin-off from Waban Inc. in 1997, Waban received a letter ruling from the Internal Revenue Service to the effect that, for federal income tax purposes, the distribution of the Company's stock to Waban's stockholders (the "Distribution") and related asset transfers would be tax-free to Waban's stockholders. Certain future events not within the control of the Company or House2Home, including, for example, certain dispositions of the Company's common stock or House2Home's common stock, could cause the Distribution not to qualify for tax-free treatment. If this occurred, the related tax liability would be payable by House2Home, although the Company has agreed to indemnify House2Home under certain circumstances for all or a portion of such tax liability.

**Item 1B. Unresolved Staff Comments**

None.

**Item 2. Properties**

We operated 165 warehouse club locations as of January 28, 2006, of which 106 are leased under long-term leases and 48 are owned. We own the buildings at the remaining 11 locations, which are subject to long-term ground leases. A listing of the number of Company locations in each state is shown on page 2.

The unexpired terms of our leases range from approximately 1 to 35 years, and average approximately 12 years. We have options to renew all but one of our leases for periods that range from approximately 5 to 50 years and average approximately 21 years. These leases require fixed monthly rental payments which are subject to various adjustments. Certain leases require payment of a percentage of the warehouse club's gross sales in excess of certain amounts. Generally, all leases require that we pay all property taxes, insurance, utilities and other operating costs.

Our home offices in Natick, Massachusetts, occupy a total of 166,000 square feet. Leases for 125,000 square feet and 4,000 square feet expire on January 31, 2011 and 2007, respectively. Leases for 37,000 square feet expire on January 31, 2009, with options to extend these leases through January 31, 2016. We own a 480,000 square foot cross-dock facility and also lease two cross-dock facilities, which occupy a total of 776,000 square feet under leases which expire in 2010 and 2021, with options to extend these leases through 2025 and 2041, respectively.

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See Note E of Notes to Consolidated Financial Statements included elsewhere in this report for additional information with respect to our leases.

### **Item 3. Legal Proceedings**

BJ's is involved in various legal proceedings that are typical of a retail business. Although it is not possible to predict the outcome of these proceedings or any related claims, we believe that such proceedings or claims will not, individually or in the aggregate, have a material adverse effect on our financial condition or results of operations.

As described in more detail in Note F to the Financial Statements (which is incorporated herein by reference), BJ's is subject to various claims relating to fraudulent credit and debit card charges, the cost of replacing cards and related monitoring expenses and other related claims. The Company is unable to predict

whether further claims will be asserted. The Company has contested and will continue to vigorously contest the claims made against it and continues to explore its defenses and possible claims against others. The Company has established a reserve on its balance sheet relating to this matter. The ultimate outcome of this matter could differ from the amounts recorded. While that difference could be material to the results of operations for any affected reporting period, it is not expected to have a material impact on consolidated financial position or liquidity.

Discussion of the House2Home bankruptcy proceeding and the VISA/Master Card antitrust litigation appear in Notes E and N, respectively, to the Financial Statements (which are incorporated herein by reference).

**Item 4. Submission of Matters to a Vote of Security Holders**

No matter was submitted to a vote of BJS's security holders during the fourth quarter of the fiscal year ended January 28, 2006.

**Item 4A. Executive Officers of the Registrant**

| <u>Name</u>          | <u>Age</u> | <u>Office and Employment During Last Five Years</u>   |
|----------------------|------------|---|
| Herbert J. Zarkin    | 67         | Chairman of the Board of the Company since July 1997; President, Chief Executive Officer and Director of Waban (1993-1997); President of the BJS Division of Waban (the BJS Division ) (1990-1993). Mr. Zarkin was also Chairman of Waban (now known as House2Home) from July 1997 to June 2002 and was President and Chief Executive Officer of House2Home from March 2000 to September 2001. House2Home filed for bankruptcy under Chapter 11 of the United States Bankruptcy Code on November 7, 2001. (See Notes B and C of Notes to the Consolidated Financial Statements included elsewhere in this report for additional information.) |
| Michael T. Wedge     | 52         | President, Chief Executive Officer and Director of the Company since September 2002; Executive Vice President, Club Operations of the Company (July 1997-September 2002)  |
| Alison G. Corcoran   | 45         | Executive Vice President, Member Insight and Marketing of the Company since September 2005; Senior Vice President, Director of Member Insight of the Company (December 2003-September 2005); Vice President and General Manager of various divisions of Polaroid Corporation (October 2000-November 2001)   |
| Frank D. Forward     | 51         | Executive Vice President, Chief Administrative Officer and Interim Chief Financial Officer of the Company since December 2005; Executive Vice President and Chief Administrative Officer of the Company (May 2005-December 2005); Executive Vice President and Chief Financial Officer of the Company (July 1997-May 2005)  |
| Edward F. Giles, Jr. | 46         | Executive Vice President, Club Operations of the Company since September 2002; Senior Vice President, Field Operations of the Company (June 2001-September 2002); Senior Vice President, Sales Operations of the Company (June 1999-June 2001)  |
| Karen Stout          | 47         | Executive Vice President, Merchandising of the Company since July 2004; President of the Atlantic and Pacific Tea Company's Super Fresh Division (July 2002-June 2004) and president of the A&P's Sav-A-Center Division (October 2000-July 2002)  |
| Kellye L. Walker     | 39         | Senior Vice President, General Counsel and Secretary of the Company since February 2003; Hill & Barlow, PC (Boston, Massachusetts law firm) Of Counsel/Member, July 2000-February 2003  |

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All officers serve at the discretion of the Board of Directors and hold office until the next annual meeting of the Board of Directors and until their successors are elected and qualified.

## PART II

## Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

BJ's common stock is listed on the New York Stock Exchange under the symbol BJS. The quarterly high and low stock prices for the fiscal years ended January 28, 2006 and January 29, 2005 were as follows:

| Quarter | Fiscal Year Ended<br>January 28, 2006 |          | Fiscal Year Ended<br>January 29, 2005 |          |
|---------|---------------------------------------|----------|---------------------------------------|----------|
|         | High                                  | Low      | High                                  | Low      |
| First   | \$ 34.70                              | \$ 25.96 | \$ 26.45                              | \$ 21.33 |
| Second  | 32.92                                 | 26.65    | 25.47                                 | 19.91    |
| Third   | 32.11                                 | 25.30    | 29.59                                 | 21.06    |
| Fourth  | 32.50                                 | 25.30    | 32.00                                 | 26.70    |

The approximate number of stockholders of record at March 24, 2006 was 2,100. BJ's has never declared or paid any cash dividends on its common stock and has no present plans to do so. For restrictions on the payment of dividends, see Note D of Notes to the Consolidated Financial Statements included elsewhere in this report.

The following table summarizes our share repurchase activity in the quarter ended January 28, 2006:

| Period                       | Total Number<br>of Shares<br>Purchased | Average Price<br>Paid per<br>Share | Total Number of<br>Shares Purchased<br>as Part of Publicly<br>Announced<br>Program (1) | Maximum Dollar<br>Value of Shares<br>that<br>May Yet Be<br>Purchased Under<br>the<br>Program |
|------------------------------|--|------------------------------------|--|--|
| <b>2005</b>                  |  |                                    |  |  |
|                              |  |                                    |  | (Dollars in Thousands)   |
| Oct 30 - Nov 26              | 84,800                                 | \$ 27.77                           | 84,800   | \$ 77,566  |
| Nov 27 - Dec 31              | 171,500                                | 27.06                              | 171,500  | 72,925   |
| Jan 1 - Jan 28               | 35,000                                 | 29.14                              | 35,000   | 71,905   |
| <b>Total for the quarter</b> | <b>291,300</b>                         | <b>\$ 27.52</b>                    | <b>291,300</b>   | <b>\$ 71,905</b>   |

- (1) We publicly announced in a press release dated August 26, 1998 that the Board of Directors authorized a program to repurchase up to \$50 million of the Company's common stock. We subsequently announced that the Board authorized increases in the program of \$50 million each in press releases dated September 16, 1999, May 25, 2000, and May 25, 2001; and additional increases of \$100 million each in press releases dated September 26, 2001, August 20, 2002 and March 1, 2005. Under the program, repurchases may be made at management's discretion, in the open market or in privately negotiated transactions. No expiration dates were set under any of the Board's authorizations. From the inception of the program through January 28, 2006, we repurchased approximately 14.0 million shares for a total of \$428.1

million, leaving a remaining authorization of \$71.9 million.

## Item 6. Selected Financial Data

|  | Fiscal Year Ended |                   |                   |                   |                  |
|--|-------------------|-------------------|-------------------|-------------------|------------------|
|  | Jan 28,<br>2006   | Jan. 29,<br>2005  | Jan. 31,<br>2004  | Feb. 1,<br>2003   | Feb. 2,<br>2002  |
| (Dollars in Thousands except Per Share Data)   |                   |                   |                   |                   |                  |
| <b>Income Statement Data</b>   |                   |                   |                   |                   |                  |
| Net sales  | \$ 7,783,949      | \$ 7,220,239      | \$ 6,553,924      | \$ 5,728,955      | \$ 5,105,912     |
| Membership fees and other  | 165,985           | 155,062           | 139,411           | 130,747           | 117,394          |
| <b>Total revenues</b>  | <b>7,949,934</b>  | <b>7,375,301</b>  | <b>6,693,335</b>  | <b>5,859,702</b>  | <b>5,223,306</b> |
| Cost of sales, including buying and occupancy costs (1)  | 7,123,693         | 6,617,495         | 6,018,088         | 5,212,124         | 4,615,291        |
| Selling, general and administrative expenses   | 610,831           | 556,234           | 502,673           | 416,063           | 362,611          |
| Provision for credit card claims (2)   | 4,000             | 7,000             |                   |                   |                  |
| Preopening expenses (1)  | 7,523             | 15,331            | 8,875             | 11,735            | 10,343           |
| <b>Operating income</b>  | <b>203,887</b>    | <b>179,241</b>    | <b>163,699</b>    | <b>219,780</b>    | <b>235,061</b>   |
| Interest income (expense), net   | 2,742             | 803               | (74)              | 293               | 4,137            |
| Gain (loss) on contingent lease obligations (3)  | 4,494             | 9,424             | 4,488             | 15,607            | (106,359)        |
| <b>Income from continuing operations before income taxes and cumulative effect of accounting principle changes</b> | <b>211,123</b>    | <b>189,468</b>    | <b>168,113</b>    | <b>235,680</b>    | <b>132,839</b>   |
| Provision for income taxes   | 82,281            | 72,884            | 63,318            | 89,871            | 49,068           |
| <b>Income from continuing operations before cumulative effect of accounting principle changes</b>                  | <b>128,842</b>    | <b>116,584</b>    | <b>104,795</b>    | <b>145,809</b>    | <b>83,771</b>    |
| Loss from discontinued operations, net of income tax benefit (3)   | (309)             | (2,183)           | (676)             | (14,943)          | (1,423)          |
| <b>Income before cumulative effect of accounting principle changes</b>   | <b>128,533</b>    | <b>114,401</b>    | <b>104,119</b>    | <b>130,866</b>    | <b>82,348</b>    |
| Cumulative effect of accounting principle changes (4)  |                   |                   | (1,253)           |                   |                  |
| <b>Net income</b>  | <b>\$ 128,533</b> | <b>\$ 114,401</b> | <b>\$ 102,866</b> | <b>\$ 130,866</b> | <b>\$ 82,348</b> |
| <b>Income per common share:</b>  |                   |                   |                   |                   |                  |
| <b>Basic earnings per share:</b>   |                   |                   |                   |                   |                  |
| Income from continuing operations before cumulative effect of accounting principle changes                         | \$ 1.89           | \$ 1.68           | \$ 1.51           | \$ 2.07           | \$ 1.16          |
| Loss from discontinued operations  |                   | (0.04)            | (0.01)            | (0.21)            | (0.02)           |
| Cumulative effect of accounting principle changes  |                   |                   | (0.02)            |                   |                  |
| <b>Net income</b>  | <b>\$ 1.89</b>    | <b>\$ 1.64</b>    | <b>\$ 1.48</b>    | <b>\$ 1.86</b>    | <b>\$ 1.14</b>   |
| <b>Diluted earnings per share:</b>   |                   |                   |                   |                   |                  |
| Income from continuing operations before cumulative effect of accounting principle changes                         | \$ 1.87           | \$ 1.66           | \$ 1.50           | \$ 2.05           | \$ 1.13          |
| Loss from discontinued operations  |                   | (0.03)            | (0.01)            | (0.21)            | (0.02)           |
| Cumulative effect of accounting principle changes  |                   |                   | (0.02)            |                   |                  |
| <b>Net income</b>  | <b>\$ 1.87</b>    | <b>\$ 1.63</b>    | <b>\$ 1.47</b>    | <b>\$ 1.84</b>    | <b>\$ 1.11</b>   |



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| <b>Balance Sheet Data</b>                           |            |            |            |            |            |
|---|------------|------------|------------|------------|------------|
| Working capital                                     | \$ 257,503 | \$ 208,852 | \$ 147,287 | \$ 117,042 | \$ 127,818 |
| Total assets  | 1,989,849  | 1,891,514  | 1,721,359  | 1,480,957  | 1,422,511  |
| Long-term debt and obligations under capital leases | 2,737      | 3,196      | 3,625      |            | 1,558      |
| Stockholders' equity                                | 1,015,979  | 939,167    | 852,221    | 740,803    | 686,567    |
| <b>Clubs open at end of year</b>                    | 165        | 157        | 150        | 140        | 130        |

- (1) See Note E of Notes to Consolidated Financial Statements
- (2) See Note F of Notes to Consolidated Financial Statements
- (3) See Note C of Notes to Consolidated Financial Statements
- (4) See Note A of Notes to Consolidated Financial Statements

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*Unless noted otherwise, the fiscal year ended January 28, 2006 is referred to as 2005. Other fiscal years are referred to in a similar manner.*

***General Overview***

BJS is a leading warehouse club operator in the eastern United States. As of January 28, 2006, we operated 163 BJS warehouse clubs, 87 of which operate gasoline stations, and two ProFoods Restaurant Supply clubs, in 16 states.

The success of our business is dependent on our ability to achieve high volumes of sales and rapid inventory turnover, to attract and retain members and to control costs. We believe that our pricing and cost structure is a major competitive advantage for us.

Our revenues are derived from the sale of a wide range of food and general merchandise items, the sale of gasoline and from membership fees.

Paid membership is an essential component in our business. It not only provides a source of revenue, but it promotes customer loyalty. Membership fees permit us to offer lower prices to our members, encouraging them to shop us more frequently. Member renewal rates are a key performance indicator for us.

Comparable store sales performance is an important measure throughout the retail industry. Our comparable club sales increase from 2004 to 2005 was 3.6%, including a contribution from gasoline of 1.3%. This year's comparable club sales performance follows very strong comparable club sales in the last two years. From 2002 to 2003, our comparable club sales increased by 7.8%, including a contribution from gasoline sales of 3.2%. From 2003 to 2004 comparable club sales increased by 6.0%, including a contribution from gasoline sales of 1.1%.

Our low merchandise margin rates drive the high sales volumes that are so critical in our business. Our merchandise margin rate is a key metric in achieving both our top-line and bottom-line objectives. We believe that the cost structure built into our business model puts us among the most efficient in the retail industry. We closely monitor our costs as a percentage of sales, particularly our payroll costs, which comprise the largest portion of our selling, general and administrative expenses.

We place a great deal of emphasis on control of our inventories. Because of our high sales volumes and inventory turns, we are able to generate cash from a large portion of our inventory before we are required to pay our merchandise vendors. The majority of our inventory purchases are routed through our cross-dock facilities, including two new state-of-the-art facilities which were built in 2001 and 2003. We monitor several inventory-related measures, including inventory turns, accounts payable as a percentage of inventories, average inventories per club and shrinkage as a percentage of sales.

***Overview of 2005 Operations***

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Despite lower than planned comparable club sales increases in 2005, we were able to drive earnings growth primarily because of very strong sales increases in private brands and fresh foods, which were priorities for us in 2005. Reduced purchasing costs driven by global sourcing and e-sourcing also helped to fuel merchandise margin expansion. Comparable club sales of food increased by 5.6% from 2004 to 2005, while comparable club sales of general merchandise decreased by 2.2% over the same period of time.

Membership renewal rates dropped slightly from last year's levels. Our percentage of Rewards members and the percentage of the sales they generated grew significantly in 2005.

Our balance sheet remains strong. As of January 28, 2006, we had cash and cash equivalents of \$162.2 million, versus cash, cash equivalents and marketable securities of \$150.4 million at the end of the previous year. Long-term debt, including current installments, was \$3.2 million as of January 28, 2006. Net cash provided by operating activities was \$199.4 million in 2005, versus last year's higher than normal total of \$248.9 million.

We opened eight new BJ's clubs and replaced one older club with a prototype club in a better location. We also began construction of a 615,000 square foot cross-dock facility in Uxbridge, Massachusetts, that will replace an older, smaller facility in the summer of 2006.

### *Outlook for 2006*

Our priorities in 2006 will be focused on building traffic in our clubs, improving our general merchandise business and accelerating our square footage growth. Traffic-building initiatives include newspaper advertising in select markets, as well as direct-mail coupon promotions focused on high-ticket general merchandise items.

We plan to sharpen our price laddering in general merchandise by simplifying our members' selection process by organizing product assortments into three price levels so that they can trade up or down in any given category. We look to continue building our fresh food business with expanded assortments of produce and home-meal replacement items.

In addition to completing construction of our new cross-dock facility in Uxbridge, MA, we plan to open 12 to 15 new clubs in 2006.

Effective January 1, 2006, we raised the cost of a BJ's membership by \$5. Because membership fees are amortized over twelve months and members renew on anniversary dates throughout the year, the full effect of the fee increase will take two years to cycle.

### *Critical Accounting Policies and Estimates*

The preparation of our financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. We review our estimates on an ongoing basis and make judgments about the carrying value of assets and liabilities based on a number of factors. These factors include historical experience, guidance provided by outside experts and assumptions made by management that are believed to be reasonable under the circumstances. This section summarizes critical accounting policies and the related judgments involved in their application.

#### *Cash Consideration Received from Vendors*

We receive various types of cash consideration from vendors, principally in the form of rebates and allowances. We recognize such vendor rebates and allowances as a reduction of cost of sales based on a systematic and rational allocation of the cash consideration offered to the underlying transaction that results in progress by BJ's toward earning the rebates and allowances, provided the amounts to be earned are probable and reasonably estimable. Otherwise, rebates and allowances are recognized only when predetermined milestones are met. We review the status of all rebates and allowances at least once per quarter and update our estimates, if necessary, at that time. We believe that our review process has allowed us to avoid material adjustments in estimates of vendor rebates and allowances.

#### *Legal Contingencies*

As described in more detail in Note F to the consolidated financial statements, BJS is subject to various claims relating to fraudulent credit and debit card charges, the cost of replacing cards and related monitoring expenses and other related claims. As required by Statement of Financial Accounting Standards No. 5, Accounting for Contingencies, ( SFAS No. 5 ) we accrue a liability if the potential loss for a claim is considered probable and the amount of the loss can be reasonably estimated.

Significant judgment is required in both the determination of probability and the determination as to whether our exposure can be reasonably estimated. In reviewing the reserve relating to the credit card claims, we make significant estimates regarding the claims that have been made for fraudulent credit and debit card charges and the cost of replacing cards, monitoring expenses, and related fees and expenses. Because of uncertainties related to this matter, accruals are based on information available at the time our financial statements are issued. Periodically, and as additional information becomes available, we reassess the potential liability and may revise our estimates and adjust our reserve.

#### *Inventories*

Merchandise inventories are stated at the lower of cost, determined under the average cost method, or market. We recognize the write-down of slow-moving or obsolete inventory in cost of sales when such write-downs are probable and estimable. Records are maintained at the stockkeeping unit (SKU) level. A report that details the number of weeks of selling supply for each SKU allows our merchandising staff to make timely markdown decisions to help maintain rapid inventory turnover, which is essential in our business. The carrying value of any SKU whose selling price is marked down to below cost is immediately reduced to that selling price.

We take physical inventories of merchandise on a cycle basis at every location each year. A second physical inventory is taken at the end of the year at selected locations. We estimate a reserve for inventory shrinkage for the period between physical inventories. This estimate is based on historical results of previous physical inventories, shrinkage trends or other judgments management believes to be reasonable under the circumstances.

#### *Long-Lived Assets*

We review the realizability of our long-lived assets annually and whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. Current and expected operating results and cash flows and other factors are considered in connection with our reviews. Significant judgments are made in projecting future cash flows and are based on a number of factors, including the maturity level of the club, historical experience of clubs with similar characteristics, recent trends and general economic assumptions. Impairment losses are measured as the difference between the carrying amount and the fair value of the impaired assets.

#### *Income Tax Reserves*

We pay income taxes to federal, state and municipal taxing authorities. We are subject to audit by these jurisdictions and maintain reserves for those uncertain tax positions which we believe may be subject to challenge. Our reserves are based on our estimate of the likely outcome of these audits, and are revised periodically based on changes in tax law and court cases involving taxpayers with similar circumstances.

#### *Reserves for Closed Store Lease Obligations*

During the fiscal year ended February 2, 2002, we established reserves for our liability related to House2Home, Inc. ( House2Home ) leases. Pursuant to an agreement with The TJX Companies, Inc. ( TJX ), we agreed to indemnify TJX for 100% of House2Home's lease liabilities guaranteed by TJX through January 31, 2003 and for 50% of any such liabilities thereafter. House2Home filed for bankruptcy in November 2001. (See Note C of Notes to Consolidated Financial Statements for additional information.) As of January 28, 2006, all 41 House2Home leases for which we were contingently liable had been settled, including lump sum settlements for 38 leases. The other three House2Home

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properties (for which we remain contingently liable) have been assigned to third parties.

During the fiscal year ended February 1, 2003, we established reserves for our lease liabilities for three BJ's clubs which were closed in November 2002. Two of these clubs were in the Columbus, Ohio, market and one was in North Dade, Florida. (See Note C of Notes to Consolidated Financial Statements for additional

information.) Our recorded liabilities have been based on the present value of rent liabilities under these leases, including estimated real estate taxes and common area maintenance charges, reduced by estimated income from the subleasing of these properties. An annual discount rate of 6% was used to calculate the present value of these lease obligations. This rate was based on the estimated incremental borrowing rate for the Company during the weighted-average period of time over which these obligations are expected to be paid.

A considerable amount of judgment was involved in determining our net liability related to the closed store leases, particularly in estimating potential sublease income. Based on our knowledge of real estate conditions in the local markets and our experience in those markets, we assume an average period of time it would take to sublease the properties and the amount of potential sublease income for each property. We reassess our liability for closed club leases at least every quarter and adjust our reserves accordingly when our estimates change.

We have made lump sum payments to settle the leases for two of the three closed clubs, including one settlement in 2005. The reserve at January 28, 2006 is based on the present value of our rent liability under the lease for the remaining club, including real estate taxes and common area maintenance charges, reduced by estimated income from subleasing the property. We will continue to use an annual discount rate of 6% to calculate the present value of the obligation.

#### *Self-Insurance Reserves*

We are primarily self-insured for worker's compensation and general liability claims. Reported reserves for these claims are derived from estimated ultimate costs based upon individual claim file reserves and estimates for incurred but not reported claims. Estimates are based on valuations provided by third-party actuaries, historical loss development factors, and other assumptions believed to be reasonable under the circumstances.

#### *Results of Operations*

The following table presents income statement data for continuing operations for the last three fiscal years:

|   | Fiscal Year Ended                              |                   |                  |                   |                  |                   |
|---|--|-------------------|------------------|-------------------|------------------|-------------------|
|   | January 28, 2006                               |                   | January 29, 2005 |                   | January 31, 2004 |                   |
|   | \$   | % of<br>Net Sales | \$               | % of<br>Net Sales | \$               | % of<br>Net Sales |
|   | (Dollars in Millions except Per Share Amounts) |                   |                  |                   |                  |                   |
| Net sales   | \$ 7,783.9                                     | 100.0%            | \$ 7,220.2       | 100.0%            | \$ 6,553.9       | 100.0%            |
| Membership fees and other                           | 166.0  | 2.1               | 155.1            | 2.1               | 139.4            | 2.1               |
| <b>Total revenues</b>                               | <b>7,949.9</b>                                 | <b>102.1</b>      | <b>7,375.3</b>   | <b>102.1</b>      | <b>6,693.3</b>   | <b>102.1</b>      |
| Cost of sales, including buying and occupancy costs | 7,123.7  | 91.5              | 6,617.5          | 91.6              | 6,018.1          | 91.8              |
| Selling, general and administrative expenses        | 610.8  | 7.8               | 556.2            | 7.7               | 502.6            | 7.7               |
| Provision for credit card claims                    | 4.0  | 0.1               | 7.0              | 0.1               |                  | 0.0               |



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|   |          |      |          |      |          |      |
|---|----------|------|----------|------|----------|------|
| Preopening expenses                                   | 7.5      | 0.1  | 15.4     | 0.2  | 8.9      | 0.1  |
| Operating income                                      | 203.9    | 2.6  | 179.2    | 2.5  | 163.7    | 2.5  |
| Interest income (expense), net                        | 2.7      | 0.0  | 0.8      | 0.0  | (0.1)    | 0.0  |
| Income on contingent lease obligations                | 4.5      | 0.1  | 9.5      | 0.1  | 4.5      | 0.1  |
| Income from continuing operations before income taxes | 211.1    | 2.7  | 189.5    | 2.6  | 168.1    | 2.6  |
| Provision for income taxes                            | 82.3     | 1.0  | 72.9     | 1.0  | 63.3     | 1.0  |
| Income from continuing operations                     | \$ 128.8 | 1.7% | \$ 116.6 | 1.6% | \$ 104.8 | 1.6% |
| Diluted earnings per common share                     | \$ 1.87  |      | \$ 1.66  |      | \$ 1.50  |      |
| Number of clubs in operation at year end              | 165      |      | 157      |      | 150      |      |

*Comparison of 2005 to 2004*

Net sales increased by 7.8% from 2004 to 2005, due to comparable club sales increases and to the opening of new clubs and new gasoline stations. The increase in comparable club sales represented approximately 45% of the total increase in net sales from 2004 to 2005. New clubs and new gasoline stations accounted for the remainder of the increase. Food accounted for 59% of total food and general merchandise sales in 2005 versus 57% in 2004.

Comparable club sales increased by 3.6% from 2004 to 2005, including a contribution from gasoline sales of 1.3%. On a comparable club basis, food sales increased by 5.6% and general merchandise sales decreased by 2.2% in 2005. Food sales were paced by our fresh food business, particularly produce. Sales of soda and water, juices, paper products and coffee were also strong. In general merchandise, sales of televisions, beauty care and tires were strong. Weaker categories included audio/video, office equipment and supplies, computer software and furniture.

Total revenues included membership fees of \$150.0 million in 2005 versus \$139.4 million in 2004. This increase was due primarily to new clubs and increased participation in BJ's Rewards Membership program. At the end of 2005, Rewards members accounted for approximately 5% of our primary members, up from approximately 3% at the end of 2004. During 2005, Rewards members accounted for approximately 10% of our food and general merchandise sales, up from approximately 7% of food and general merchandise sales in 2004. Inner Circle members renewed at a rate of 83.2% in 2005 versus 83.6% in 2004. Business members renewed at a rate of 87.3% in 2005 compared with 87.9% in 2004.

Cost of sales (including buying and occupancy expenses) was 91.52% of net sales in 2005 versus 91.65% of net sales in 2004. The decrease in the cost of sales ratio was attributable to higher merchandise gross margin rates, partially offset by the increased proportion of gasoline sales, which carry a significantly lower margin than the remainder of our business, and an increase in buying and occupancy costs as a percentage of sales.

The increase in the merchandise gross margin ratio was due in large part to a significant increase in private brand sales, as well as reduced acquisition costs realized through global sourcing and e-sourcing. The gross margin rate on gasoline sales in 2005 was lower than that of the previous year. Buying and occupancy costs as a percentage of sales increased by approximately 21 basis points, due mainly to higher costs for utilities.

Selling, general and administrative (SG&A) expenses were 7.85% of net sales in 2005 versus 7.70% in 2004. The increase in the SG&A ratio was due mainly to increases in payroll and fringe benefits, insurance and marketing, partially offset by the \$3.1 million pretax VISA/MasterCard settlement (see Note N of Notes to Consolidated Financial Statements).

Total SG&A expenses rose by \$54.6 million from 2004 to 2005, due mainly to the factors that increased SG&A expenses as a percentage of sales, as well as the addition of new clubs. Payroll and payroll benefits accounted for 76% of all SG&A expenses in 2005 versus 77% in 2004. Payroll and payroll benefits accounted for 72% of the increase in SG&A expenses from 2004 to 2005.

In 2004 we recorded pretax charges of \$7.0 million to establish a reserve for claims seeking reimbursement for fraudulent credit and debit card charges and the cost of replacing cards, monitoring expenses and related fees and expenses. In 2005 we recorded additional pretax charges of \$4.0 million to increase our reserve, primarily because of increases in our estimate of legal costs to be incurred in connection with this matter. See Note F of Notes to Consolidated Financial Statements for additional information.

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Preopening expenses were \$7.5 million in 2005 versus \$15.4 million in 2004. Preopening expenses in 2004 included corrections to our accounting for leases of \$8.2 million. See Note E of Notes to Consolidated Financial Statements for additional information. We opened eight new clubs and relocated one club in 2005. We opened seven new clubs in 2004.

Interest income, net was \$2.7 million in 2005 compared with \$0.8 million in 2004. This change was due mainly to increases in interest rates, as well as higher levels of invested cash in 2005. See Note M of Notes to Consolidated Financial Statements for a summary of the components of interest income (expense), net.

During 2005 we received pretax recoveries of House2Home bankruptcy claims totaling \$4.4 million, which we recorded in gain on contingent lease obligations. We also recorded a gain of \$0.1 million to decrease our reserve for contingent lease obligations in 2005. We recorded pretax gains of \$2.7 million in 2004 to reduce our liability for contingent lease obligations. These were partially offset by pretax accretion charges in connection with these obligations of \$0.2 million. During 2004, we also received pretax recoveries on account of our House2Home bankruptcy claims of \$7.0 million. See Notes C and E of Notes to Consolidated Financial Statements for additional information.

In October 2004, we began testing a concept that is new to BJs by opening the first of two new clubs in the Metro New York market exclusively for food service businesses under the name ProFoods Restaurant Supply. Our second ProFoods club was opened in January 2005. The business model for ProFoods is built on somewhat higher merchandise margins than those generated by a wholesale club, free memberships and a broad merchandise assortment to support one-stop shopping, primarily on a cash and carry basis. We still consider ProFoods as a new venture that will take time to develop. In its first full year of operation, the business did not perform fully to our expectations. We are seeking to improve sales and margin at our two locations in Metro New York.

Our income tax provision was 39.0% of pretax income from continuing operations in 2005 versus 38.5% in 2004. The provision for credit card claims, the gains from contingent lease obligations and House2Home bankruptcy recoveries, and expenses recorded in connection with corrections to our accounting for leases were taxed at incremental tax rates. Tax rates of 39.1% and 38.7% were applied to all other pretax income from continuing operations in 2005 and 2004, respectively. The increase in our rates in 2005 was primarily due to higher effective state tax rates.

Income from continuing operations was \$128.8 million, or \$1.87 per diluted share, in 2005 versus \$116.6 million, or \$1.66 per diluted share, in 2004.

In 2005, income from continuing operations included the following income and expense items:

Income of \$3.1 million, or \$.04 per diluted share, to record House2Home bankruptcy recoveries and reductions to our reserve for contingent lease obligations.

Income of \$1.9 million, or \$.03 per diluted share, in connection with a settlement in the VISA/MasterCard antitrust class action litigation.

Expense of \$2.4 million, or \$.03 per diluted share, to increase the reserve for credit card claims.

In 2004, income from continuing operations included the following income and expense items:

Income of \$6.1 million, or \$.09 per diluted share, to record House2Home bankruptcy recoveries and reductions to our reserve for contingent lease obligations.

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Expense of \$4.2 million, or \$.06 per diluted share, to establish a reserve for credit card claims.

Expense of \$4.3 million, or \$.06 per diluted share, to record lease accounting corrections.

Loss from discontinued operations, net of tax benefit, was \$0.3 million in 2005 and consisted entirely of accretion charges. Loss from discontinued operations, net of tax benefit, was \$2.2 million, or \$.03 per diluted share, in 2004. This included a post-tax loss of \$1.7 million, or \$.02 per diluted share, to increase our closed club reserves.

Net income was \$128.5 million, or \$1.87 per diluted share, in 2005 versus \$114.4 million, or \$1.63 per diluted share, in 2004.

*Comparison of 2004 to 2003*

Net sales increased by 10.2% from 2003 to 2004, due to comparable club sales increases and to the opening of new clubs and new gasoline stations. The increase in comparable club sales represented approximately 58% of the total increase in net sales from 2003 to 2004. New clubs and new gasoline stations accounted for the remainder of the increase. Adjusting each period for shifts of certain items between food and general merchandise categories, food accounted for 57% of total food and general merchandise sales in 2004 versus 55% in 2003.

Comparable club sales increased by 6.0% from 2003 to 2004, including a contribution from gasoline sales of 1.1%. On a comparable club basis food sales increased by 9.4% and general merchandise sales decreased by 0.1% in 2004. Food sales were strong throughout the year, paced by our fresh food business, beverages, dairy and paper products. General merchandise sales were adversely affected by the planned contraction of certain categories, including automotive and tools, furniture, office supplies and sporting goods.

Total revenues included membership fees of \$139.4 million in 2004 versus \$124.2 million in 2003. This increase was due primarily to new clubs, strong member renewal rates and increased participation in BJ's Rewards Membership program. Inner Circle members renewed at a rate of 83.6% in 2004 versus 83.5% in 2003. Business members renewed at a rate of 87.9% in 2004 compared with 86.5% in 2003.

Cost of sales (including buying and occupancy expenses) was 91.65% of net sales in 2004 versus 91.82% of net sales in 2003. Despite 2004's increased contribution of gasoline sales, which carry a significantly lower gross margin than the remainder of our business, the cost of sales ratio in 2004 was favorable to 2003 primarily because of higher merchandise margins. Gasoline margin in 2004 was also favorable to 2003. Buying and occupancy costs as a percentage of sales in 2004 approximated 2003's rate. Buying and occupancy expenses were reduced by \$1.0 million as a result of a correction to our accounting for leases in 2004. See Note E of Notes to Consolidated Financial Statements for additional information.

The improvement in merchandise margins was due mainly to stronger sales of private brands and fresh foods and our shift to self-run produce. We were also able to reduce purchasing costs through e-sourcing and global sourcing.

SG&A expenses were 7.70% of net sales in 2004 versus 7.67% in 2003. The increase in the SG&A ratio was due mainly to increases in payroll and fringe benefits (which included higher group medical expenses), credit expenses (resulting mainly from a higher penetration of credit transactions) and professional services, which primarily related to Sarbanes-Oxley 404 compliance requirements. These increases were partially offset by significantly lower advertising expenses.

Total SG&A expenses rose by \$53.6 million from 2003 to 2004, due mainly to the factors that increased SG&A expenses as a percentage of sales, as well as the addition of new clubs. Payroll and payroll benefits accounted for 77% of all SG&A expenses in 2004 versus 75% in 2003. Major changes in SG&A expenses from 2003 to 2004 included increases in payroll and benefits of \$48.1 million, credit expenses of \$11.0 million and professional services of \$3.5 million. These were partially offset by decreases in advertising expenses of \$6.8 million, reflecting our plan to reduce this category in 2004.

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In 2004 we recorded pretax charges of \$7.0 million to establish a reserve for claims seeking reimbursement for fraudulent credit and debit card charges and the cost of replacing cards, monitoring expenses and related fees and expenses. See Note F of Notes to Consolidated Financial Statements for additional information.

Preopening expenses were \$15.3 million in 2004 versus \$8.9 million in 2003. Preopening expenses in 2004 included corrections to our accounting for leases of \$8.2 million. See Note E of Notes to Consolidated Financial Statements for additional information. We opened seven new clubs in 2004. We opened ten new clubs and a new cross-dock facility in Jacksonville, Florida, in 2003.

Interest income, net was \$0.8 million in 2004 compared with net interest expense of \$0.1 million in 2003. This change was due primarily to higher levels of invested cash in 2004. See Note M of Notes to Consolidated Financial Statements for a summary of the components of interest income (expense), net.

Based on significant progress made in settling liabilities for House2Home leases, we recorded pretax gains of \$2.7 million in 2004 and \$5.5 million in 2003 to reduce our liability for contingent lease obligations. These were partially offset by pretax accretion charges in connection with these obligations of \$0.2 million in 2004 and \$1.0 million in 2003. See Note C of Notes to Consolidated Financial Statements for additional information. During 2004, we also received pretax recoveries on account of our House2Home bankruptcy claims of \$7.0 million, which are included in gain on contingent lease obligations. See Note E of Notes to Consolidated Financial Statements for additional information.

Our income tax provision was 38.5% of pretax income from continuing operations in 2004. The provision for credit card claims, the gains from contingent lease obligations and House2Home bankruptcy recoveries, and expenses recorded in connection with corrections to our accounting for leases were taxed at incremental tax rates. A tax rate of 38.7% was applied to all other pretax income from continuing operations.

In 2003, our income tax provision was 37.7% of pretax income from continuing operations, which included a credit of \$1.7 million in connection with a settlement between BJ's and House2Home in the fourth quarter. (See Note E of Notes to Consolidated Financial Statements.) Excluding this credit, our income tax provision in 2003 was 38.7% of pretax income from continuing operations.

Income from continuing operations was \$116.6 million, or \$1.66 per diluted share, in 2004 versus \$104.8 million, or \$1.50 per diluted share, in 2003.

In 2004, income from continuing operations included the following income and expense items:

Income of \$6.1 million, or \$.09 per diluted share, to record House2Home bankruptcy recoveries and reductions to our reserve for contingent lease obligations.

Expense of \$4.2 million, or \$.06 per diluted share, to establish a reserve for credit card claims.

Expense of \$4.3 million, or \$.06 per diluted share, to record lease accounting corrections.

In 2003, income from continuing operations included the following income and expense items:

Income of \$3.3 million, or \$.05 per diluted share, to record reductions to our reserve for contingent lease liabilities.



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Income of \$1.7 million, or \$.02 per diluted share, to record a tax settlement between BJ s and House2Home.

Loss from discontinued operations, net of tax benefit, was \$2.2 million, or \$.03 per diluted share, in 2004. This included a post-tax loss of \$1.7 million, or \$.02 per diluted share, to increase our closed club reserves. Loss from discontinued operations, net of tax benefit, was \$.7 million, or \$.01 per diluted share, in 2003, which consisted primarily of interest accretion charges related to three clubs which closed in November 2002.

As of the beginning of 2003, we adopted the provisions of Statement of Financial Accounting Standards No. 143, Accounting for Asset Retirement Obligations ( SFAS No. 143 ). We recorded a post-tax charge of

\$1.3 million, or \$.02 per diluted share, in the first quarter to reflect the cumulative effect of adopting this accounting principle change in 2003. See Note A of Notes to Consolidated Financial Statements for additional information.

Net income was \$114.4 million, or \$1.63 per diluted share, in 2004 versus \$102.9 million, or \$1.47 per diluted share, in 2003.

### *Seasonality*

BJ's business, in common with the business of retailers generally, is subject to seasonal influences. Our sales and operating income have typically been strongest in the fourth quarter holiday season and lowest in the first quarter of each fiscal year.

### *Recently Issued Accounting Standards*

See *Summary of Accounting Policies - Recently Issued Accounting Standards* in Notes to Consolidated Financial Statements for a summary of recently issued standards.

### *Liquidity and Capital Resources*

Net cash provided by operating activities was \$199.4 million in 2005 compared with \$248.9 million in 2004 and \$199.9 million in 2003. The decrease in net cash provided by operating activities in 2005 versus 2004 was due principally to decreases in cash due to changes in certain balance sheet accounts, which are affected by the timing of payments. The largest year over year changes were \$19.1 million in accrued income taxes; \$13.5 million in accrued expenses; \$10.6 million in merchandise inventories, net of accounts payable; and \$6.6 million in noncurrent liabilities. The decrease in cash flow in accrued income taxes from 2004 to 2005 was due in large part to the absence of accelerated depreciation benefits which were provided for under the Job Creation and Worker Assistance Act of 2002. These benefits are not available for assets placed in service after 2004. The increase in net cash provided by operating activities in 2004 versus 2003 was due principally to an increase in net income before the cumulative effect of accounting changes and before depreciation and amortization of \$22.1 million and a decrease in payments for closed store lease obligations of \$26.0 million.

In 2005, we opened eight new clubs and relocated one club. All of these clubs are leased. We also opened six new gasoline stations in 2005. Cash expended for property additions was \$123.1 million in 2005, \$133.3 million in 2004 and \$176.9 million in 2003. In 2004, we opened seven new clubs and three gasoline stations, and remodeled six existing clubs. One of the new clubs is owned at a location that is subject to a ground lease. The other new clubs are leased.

We expect that capital expenditures will total approximately \$200 to \$220 million in 2006, based on plans to open 12 to 15 new clubs and 10 to 12 gasoline stations. Planned capital expenditures in 2006 include approximately \$35 to \$40 million for the completion of our new cross-dock facility in Uxbridge, Massachusetts, which we plan to open in the summer. The timing of actual openings and the amount of related expenditures could vary from the estimates above due, among other things, to the complexity of the real estate development process.

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On February 28, 2005, the Board of Directors authorized the repurchase of up to an additional \$100 million of the Company's common stock. In 2005, we repurchased 2,535,600 shares of our common stock for \$73.2 million, or an average price of \$28.88 per share. In 2004, we repurchased 1,725,200 shares of our common stock for \$45.3 million, or an average price of \$26.27 per share. We did not repurchase any BJS stock in 2003. From the inception of our share repurchase activities in August 1998, we have repurchased a total of \$428.1 million of common stock at an average cost of \$30.52 per share. As of January 28, 2006, our remaining repurchase authorization was \$71.9 million.

In January 2004, we assumed a real estate mortgage with a principal balance of \$4,025,000 in connection with the purchase of a club that was previously leased. This debt carries an interest rate of 7%, is payable in monthly installments maturing through November 1, 2011 and has a prepayment penalty. The principal balance at January 28, 2006 was \$3.2 million.

On April 28, 2005, we entered into a new \$225 million unsecured credit agreement with a group of banks which expires April 27, 2010. The new agreement includes a \$50 million sub-facility for letters of credit, of which \$2.3 million was outstanding at January 28, 2006. We are required to pay an annual facility fee which is currently 0.15% of the total commitment. Interest on borrowings is payable at BJs option either at (a) the Eurodollar rate plus a margin which is currently 0.475% or (b) a rate equal to the higher of (i) the sum of the Federal Funds Effective Rate plus 0.50% or (ii) the agent bank's prime rate. We are also required to pay a usage fee whenever the amount of loans and undrawn or unreimbursed letters of credit outstanding exceeds 50% of the total commitment. The usage fee, if applicable, would be at an annual rate of 0.125% of the amount borrowed. The facility fee and Eurodollar margin are subject to change based upon our fixed charge coverage ratio. The agreement contains financial covenants which include a minimum fixed charge coverage requirement and a maximum adjusted debt to capital limitation. We are required to comply with these covenants on a quarterly basis. Under the credit agreement, we may pay dividends or repurchase our own stock in any amount so long as we remain in compliance with all requirements under the agreement. We have no credit rating triggers that would accelerate the maturity date of debt if borrowings were outstanding under our credit agreement. We were in compliance with the covenants and other requirements set forth in our credit agreement at January 28, 2006.

In addition to the credit agreement, we maintain a separate \$62 million facility for letters of credit, primarily to support the purchase of inventories, of which \$36.6 million was outstanding at January 28, 2006, and we also maintain a \$25 million uncommitted credit line for short-term borrowings which expires on September 30, 2006. As of January 28, 2006, we also had a standalone letter of credit in the amount of \$4.4 million outstanding at year end, which is used to support our self-insurance program for workers' compensation.

There were no borrowings outstanding under our bank credit agreement or our uncommitted credit line at January 28, 2006 and January 29, 2005.

Increases in inventories and accounts payable from January 29, 2005 to January 28, 2006 were due mainly to the addition of new clubs and an increase of 1.9% in the average inventory per club in the same time period.

Pursuant to an agreement with TJX and in connection with House2Home's filing for bankruptcy on November 7, 2001, we recorded a pretax charge of \$105.0 million in 2001 for our estimated loss associated with House2Home leases. Based on our continuing evaluation of our remaining obligations and the significant progress made in settling liabilities for House2Home leases, we recorded pretax gains of \$20.0 million in 2002, \$5.5 million in 2003, \$2.7 million in 2004 and \$0.1 million in 2005 to reduce our estimated liability related to House2Home contingent lease obligations.

As of January 28, 2006, we have settled all 41 House2Home leases for which we were originally contingently liable, including lump sum settlements for 38 leases. The other three House2Home properties (for which we remain contingently liable) have been assigned to third parties.

During the third quarter of 2002, we established reserves for our liability related to leases for three BJs clubs which closed on November 9, 2002. (See Note C of Notes to Consolidated Financial Statements for additional information.) Our recorded liabilities were based on the present value of rent liabilities under the three leases, including estimated real estate taxes and common area maintenance charges, reduced by estimated income from the subleasing of these properties. An annual discount rate of 6% was used to calculate the present value of these lease obligations. This rate was based on estimated borrowing rates for the Company that took into consideration the weighted-average period of time over which these obligations are expected to be paid.

During 2004, we made a lump sum payment to settle the lease for one of the three closed clubs. Based on this settlement and an evaluation of the status of the two remaining properties, we recorded a pretax charge of \$2.9 million in 2004 to increase our reserve for closed clubs. In 2005, we made a lump sum payment to settle the

lease of a second closed club. The settlement was consistent with the amount which we had reserved for this club. The reserve at January 28, 2006 is based on the present value of our rent liability under the lease for the other remaining club, including real estate taxes and common area maintenance charges, reduced by estimated future income from subleasing the property. We will continue to use an annual discount rate of 6% to calculate the present value of the obligation.

We believe that the liabilities recorded in the financial statements adequately provide for these lease obligations. However, there can be no assurance that our actual liability for closed store obligations will not differ materially from amounts recorded in the financial statements due to a number of factors, including future economic factors which may affect the ability to successfully sublease, assign or otherwise settle liabilities related to these properties. We consider our maximum reasonably possible undiscounted pretax exposure for our closed store lease obligations to be approximately \$21 million at January 28, 2006.

BJ's has filed proofs of claim against House2Home, Inc. for claims arising under certain agreements between BJ's and House2Home in connection with the Company's spin-off from Waban Inc. in July 1997. These claims arise primarily from BJ's indemnification of TJX with respect to TJX's guarantee of House2Home leases and from the Tax Sharing Agreement dated July 28, 1997 between BJ's and House2Home. House2Home and BJ's have settled BJ's claims against House2Home. The settlement provides that BJ's will have an unsecured claim of approximately \$38 million, on account of claims under the Tax Sharing Agreement and indemnification payments which have been made to TJX. The settlement agreement was approved by the United States Bankruptcy Court for the Central District of California on November 10, 2003. As part of the settlement, BJ's has been released of all claims that House2Home and its bankruptcy estate may have had against BJ's, including \$1.7 million owed by BJ's to House2Home under the Tax Sharing Agreement. We recognized this amount as a reduction in our tax provision in the fourth quarter of 2003.

During 2005, we received pretax recoveries on account of our House2Home bankruptcy claims of \$4.4 million. These recoveries are recorded in gain on contingent lease obligations in the statements of income. On a post-tax basis, these gains totaled \$3.0 million.

During 2004, we received pretax recoveries on account of our House2Home bankruptcy claims totaling \$7.0 million, including a payment of \$2.5 million to settle our claim against the Indenture Trustee for House2Home's Convertible Subordinated Notes. We have no further claims against the Indenture Trustee. These recoveries are also included in gain on contingent lease obligations in the statements of income. On a post-tax basis these gains totaled \$4.6 million.

In March 2006, we received bankruptcy recoveries of \$3.1 million on account of our House2Home bankruptcy claims. On a post-tax basis, these gains were \$2.1 million. The Bankruptcy Court has closed our case, and we do not expect to receive further payments on our claims. The recoveries that we received in March 2006 will be recorded in the first quarter of the fiscal year ending February 3, 2007.

Early in 2004 we were notified by credit card issuers that credit and debit card accounts used legitimately at BJ's were subsequently used in fraudulent transactions at non-BJ's locations. In response, we retained a leading computer security firm to conduct a forensic analysis of our information technology systems with a goal of determining whether a breach had in fact occurred. While no conclusive evidence of a breach was found, the computer security firm concluded that: (1) our centralized computer system that serves as the aggregation point for all BJ's credit and debit card transactions chain-wide had not been breached and (2) any breach would have likely occurred in a more decentralized fashion involving club-level systems. On March 12, 2004, after our receipt of the computer security firm's preliminary report of findings, we issued a public statement alerting consumers to the potential security breach.

In 2004, we recorded pretax charges of \$7.0 million (\$4.2 million post-tax) to establish a reserve for claims seeking reimbursement for fraudulent credit and debit card charges and the cost of replacing cards, monitoring expenses and related fees and expenses.



In 2005, we recorded additional charges of \$4.0 million (\$2.4 million post-tax) to increase our reserve. These charges were driven primarily by an increase in our estimate of legal costs to be incurred in connection with this matter. As of January 28, 2006, the balance in the reserve was \$4.5 million, which represented our best estimate of the remaining cost and expenses related to this matter at that time. This reserve is included in accrued expenses and other current liabilities on our balance sheet.

In connection with this matter, on September 20, 2005 the Company entered into a consent decree with the Federal Trade Commission ( FTC ), which has jurisdiction over consumer protection matters. The full text of the consent decree can be found on the FTC s website. In summary, BJ s has not admitted any wrongdoing or that the facts alleged in the FTC s complaint are true. Under the consent decree, BJ s will pay no fines or damages. BJ s has agreed, however, to maintain a comprehensive information security program, much of which was put in place shortly after BJ s first learned of the possible compromise, and to a biannual assessment of that program by an independent third party.

As of March 31, 2006, the amount of outstanding claims, which are primarily from credit card issuing banks, was approximately \$13 million. We are unable to predict whether further claims will be asserted. We have contested and will continue to vigorously contest the claims made against us and continue to explore our defenses and possible claims against others.

The ultimate outcome of this matter could differ from the amounts recorded. While that difference could be material to the results of operations for any affected reporting period, it is not expected to have a material impact on our consolidated financial position or liquidity.

BJ s had no off-balance sheet arrangements at any time during the fiscal year ended January 28, 2006.

The following summarizes our contractual cash obligations as of January 28, 2006 and the effect these obligations are expected to have on our liquidity and cash flows in future periods:

| Contractual Obligations        | Payments Due by Period |                   |                   |                   |                     |
|--------------------------------|------------------------|-------------------|-------------------|-------------------|---------------------|
|                                | Total                  | Less Than         |                   |                   | More Than           |
|                                |                        | 1 Year            | 1-3 Years         | 3-5 Years         | 5 Years             |
|                                | (Dollars in Thousands) |                   |                   |                   |                     |
| Long-term debt                 | \$ 3,903               | \$ 669            | \$ 1,338          | \$ 1,338          | \$ 558              |
| Operating leases               | 2,247,086              | 129,550           | 270,120           | 276,545           | 1,570,871           |
| Purchase obligations           | 470,530                | 421,723           | 27,518            | 17,058            | 4,231               |
| Closed store lease obligations | 8,954                  | 795               | 1,680             | 1,704             | 4,775               |
| Other long-term liabilities    | 50,090                 | 56                | 15,963            | 6,141             | 27,930              |
|                                | <u>\$ 2,780,563</u>    | <u>\$ 552,793</u> | <u>\$ 316,619</u> | <u>\$ 302,786</u> | <u>\$ 1,608,365</u> |

In the table above, long-term debt consists of a real estate mortgage which matures through November 1, 2011. Amounts for long-term debt include interest as well as principal.



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Amounts for operating leases reflect future minimum lease payments as disclosed in Note E of Notes to Consolidated Financial Statements. We have options to renew all but one of our leases. The table above does not reflect any lease payments we would make pursuant to such renewal options, except for ground leases that include reasonably assured renewal options.

Approximately 75% of purchase obligations represent future payments for merchandise purchases. The remainder consists primarily of capital commitments and purchased services.

Amounts for closed store lease obligations comprise our liabilities on the balance sheet at January 28, 2006 for a closed BJs club. Timing of payments was based on our estimates of when these liabilities would likely be satisfied through lease payments, net of estimated sublease income.

Amounts for other long-term liabilities consist mainly of payments for self-insured worker's compensation and general liability claims and for asset retirement obligations, both of which are included on our balance sheet at January 28, 2006. The estimated timing of payments for insurance claims was based primarily on recent payment experience. The timing of asset retirement obligation payments corresponds to the end of the estimated useful life assigned to the assets. Not included in other noncurrent liabilities in the table above were payments of \$23.3 million for our rent escalation liabilities because they are already included in the operating leases line, and deferred revenue of \$2.6 million, which is not a cash obligation.

Cash, cash equivalents and short-term marketable securities totaled \$162.2 million as of January 28, 2006. We believe that our current resources, together with anticipated cash flow from operations, will be sufficient to finance our operations through the term of our bank credit agreement. However, we may from time to time seek to obtain additional financing.

**Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

We believe that our potential exposure to market risk as of January 28, 2006 is not material because of the short contractual maturities of our cash and cash equivalents on that date. There were no borrowings outstanding under our bank credit agreement or its uncommitted credit line at January 28, 2006. We have not used derivative financial instruments. See Summary of Accounting Policies Disclosures about Fair Value of Financial Instruments and Note D in Notes to Consolidated Financial Statements.

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**Item 8. Financial Statements and Supplementary Data**

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## BJS WHOLESALE CLUB, INC.

## CONSOLIDATED STATEMENTS OF INCOME

|  | Fiscal Year Ended                               |                     |                     |
|--|---|---------------------|---------------------|
|  | January 28,<br>2006                             | January 29,<br>2005 | January 31,<br>2004 |
|  | (Dollars in Thousands except Per Share Amounts) |                     |                     |
| Net sales  | \$ 7,783,949                                    | \$ 7,220,239        | \$ 6,553,924        |
| Membership fees and other  | 165,985   | 155,062             | 139,411             |
| <b>Total revenues</b>  | <b>7,949,934</b>                                | <b>7,375,301</b>    | <b>6,693,335</b>    |
| Cost of sales, including buying and occupancy costs                                      | 7,123,693                                       | 6,617,495           | 6,018,088           |
| Selling, general and administrative expenses   | 610,831   | 556,234             | 502,673             |
| Provision for credit card claims   | 4,000   | 7,000               |                     |
| Preopening expenses  | 7,523   | 15,331              | 8,875               |
| <b>Operating income</b>  | <b>203,887</b>                                  | <b>179,241</b>      | <b>163,699</b>      |
| Interest income, net   | 2,742   | 803                 | (74)                |
| Gain on contingent lease obligations   | 4,494   | 9,424               | 4,488               |
| <b>Income from continuing operations before income taxes</b>                             | <b>211,123</b>                                  | <b>189,468</b>      | <b>168,113</b>      |
| Provision for income taxes   | 82,281  | 72,884              | 63,318              |
| <b>Income from continuing operations</b>   | <b>128,842</b>                                  | <b>116,584</b>      | <b>104,795</b>      |
| Loss from discontinued operations, net of income tax benefit of \$205, \$1,455 and \$451 | (309)   | (2,183)             | (676)               |
| <b>Income before cumulative effect of accounting principle changes</b>                   | <b>128,533</b>                                  | <b>114,401</b>      | <b>104,119</b>      |
| Cumulative effect of accounting principle changes  |   |                     | (1,253)             |
| <b>Net income</b>  | <b>\$ 128,533</b>                               | <b>\$ 114,401</b>   | <b>\$ 102,866</b>   |
| <b>Basic earnings per common share:</b>  |   |                     |                     |
| Income from continuing operations  | \$ 1.89   | \$ 1.68             | \$ 1.51             |
| Loss from discontinued operations  |   | (0.04)              | (0.01)              |
| Cumulative effect of accounting principle changes  |   |                     | (0.02)              |
| <b>Net income</b>  | <b>\$ 1.89</b>                                  | <b>\$ 1.64</b>      | <b>\$ 1.48</b>      |
| <b>Diluted earnings per common share:</b>  |   |                     |                     |
| Income from continuing operations  | \$ 1.87   | \$ 1.66             | \$ 1.50             |
| Loss from discontinued operations  |   | (0.03)              | (0.01)              |
| Cumulative effect of accounting principle changes  |   |                     | (0.02)              |
| <b>Net income</b>  | <b>\$ 1.87</b>                                  | <b>\$ 1.63</b>      | <b>\$ 1.47</b>      |

Number of common shares for earnings per share computations:

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|  |                   |                   |                   |
|--|-------------------|-------------------|-------------------|
| Basic  | 68,005,849        | 69,580,978        | 69,521,408        |
| Diluted  | 68,755,471        | 70,131,653        | 69,815,020        |
| Pro forma amounts assuming accounting principle changes are applied retroactively: |                   |                   |                   |
| Net income   | \$ 128,533        | \$ 114,401        | \$ 104,119        |
|  | <u>          </u> | <u>          </u> | <u>          </u> |
| Basic earnings per common share  | \$ 1.89           | \$ 1.64           | \$ 1.50           |
|  | <u>          </u> | <u>          </u> | <u>          </u> |
| Diluted earnings per common share  | \$ 1.87           | \$ 1.63           | \$ 1.49           |
|  | <u>          </u> | <u>          </u> | <u>          </u> |

The accompanying notes are an integral part of the financial statements.

## BJS WHOLESALE CLUB, INC.

## CONSOLIDATED BALANCE SHEETS

|  | January 28,<br>2006 | January 29,<br>2005 |
|--|---------------------|---------------------|
| (Dollars in Thousands)   |                     |                     |
| <b>ASSETS</b>  |                     |                     |
| Current assets:  |                     |                     |
| Cash and cash equivalents  | \$ 162,164          | \$ 125,558          |
| Marketable securities  |                     | 24,800              |
| Accounts receivable  | 101,435             | 87,292              |
| Merchandise inventories  | 813,270             | 759,742             |
| Current deferred income taxes  | 24,805              | 25,665              |
| Prepaid expenses   | 18,195              | 19,922              |
|  | <u>1,119,869</u>    | <u>1,042,979</u>    |
| Property at cost:  |                     |                     |
| Land and buildings   | 583,950             | 564,237             |
| Leasehold costs and improvements   | 187,094             | 152,547             |
| Furniture, fixtures and equipment  | 542,489             | 514,838             |
|  | <u>1,313,533</u>    | <u>1,231,622</u>    |
| Less: accumulated depreciation and amortization  | 466,108             | 405,737             |
|  | <u>847,425</u>      | <u>825,885</u>      |
| Other assets   | 22,555              | 22,650              |
|  | <u>22,555</u>       | <u>22,650</u>       |
| Total assets   | <u>\$ 1,989,849</u> | <u>\$ 1,891,514</u> |
| <b>LIABILITIES</b>   |                     |                     |
| Current liabilities:   |                     |                     |
| Current installments of long-term debt   | \$ 460              | \$ 429              |
| Accounts payable   | 556,968             | 533,345             |
| Accrued expenses and other current liabilities   | 252,575             | 238,911             |
| Accrued federal and state income taxes   | 51,568              | 54,321              |
| Closed store lease obligations due within one year                                     | 795                 | 7,121               |
|  | <u>862,366</u>      | <u>834,127</u>      |
| Total current liabilities  | <u>862,366</u>      | <u>834,127</u>      |
| Long-term debt, less portion due within one year                                       | 2,737               | 3,196               |
| Noncurrent closed store lease obligations  | 8,159               | 8,870               |
| Other noncurrent liabilities   | 75,976              | 73,756              |
| Deferred income taxes  | 24,632              | 32,398              |
| Commitments and contingencies  |                     |                     |
| <b>STOCKHOLDERS EQUITY</b>   |                     |                     |
| Preferred stock, par value \$.01, authorized 20,000,000 shares, no shares issued       |                     |                     |
| Common stock, par value \$.01, authorized 180,000,000 shares, issued 74,410,190 shares | 744                 | 744                 |
| Additional paid-in capital   | 31,277              | 37,827              |
| Unearned compensation  | (1,797)             | (2,629)             |

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|   |                   |                   |
|---|-------------------|-------------------|
| Retained earnings                                       | 1,207,417         | 1,078,909         |
| Treasury stock, at cost, 7,017,305 and 5,320,687 shares | (221,662)         | (175,684)         |
|   | <u>          </u> | <u>          </u> |
| Total stockholders' equity                              | 1,015,979         | 939,167           |
|   | <u>          </u> | <u>          </u> |
| Total liabilities and stockholders' equity              | \$ 1,989,849      | \$ 1,891,514      |
|   | <u>          </u> | <u>          </u> |

The accompanying notes are an integral part of the financial statements.

## BJS WHOLESALE CLUB, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

|   | Fiscal Year Ended      |                  |                  |
|---|------------------------|------------------|------------------|
|   | January<br>28,         | January<br>29,   | January 31,      |
|   | 2006                   | 2005             | 2004             |
|   | (Dollars in Thousands) |                  |                  |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                                       |                        |                  |                  |
| Net income  | \$ 128,533             | \$ 114,401       | \$ 102,866       |
| Adjustments to reconcile net income to net cash provided by operating activities: |                        |                  |                  |
| Provision for credit card claims  | 4,000                  | 7,000            |                  |
| Gain on contingent lease obligations  | (110)                  | (2,458)          | (4,488)          |
| Provision for store closing costs and asset impairment losses                     | 527                    | 6,025            | 3,468            |
| Provision for lease accounting corrections  |                        | 7,234            |                  |
| Cumulative effect of accounting principle changes                                 |                        |                  | 1,253            |
| Depreciation and amortization of property   | 103,807                | 98,900           | 87,050           |
| Loss on property disposals  | 952                    | 502              | 1,154            |
| Other noncash items (net)   | 2,185                  | 1,568            | 903              |
| Deferred income taxes   | (6,906)                | (8,109)          | 22,917           |
| Tax benefit from exercise of stock options  | 4,119                  | 4,343            | 999              |
| Increase (decrease) in cash due to changes in:                                    |                        |                  |                  |
| Accounts receivable   | (14,143)               | (8,370)          | (15,543)         |
| Merchandise inventories   | (53,528)               | (50,380)         | (77,827)         |
| Prepaid expenses  | 1,727                  | 2,718            | (3,614)          |
| Other assets  | (45)                   | 194              | (466)            |
| Accounts payable  | 30,587                 | 38,018           | 71,059           |
| Accrued expenses  | 7,138                  | 20,645           | 26,146           |
| Accrued income taxes  | (2,752)                | 16,393           | 12,960           |
| Closed store lease obligations  | (7,441)                | (7,100)          | (33,061)         |
| Other noncurrent liabilities  | 778                    | 7,366            | 4,167            |
| Net cash provided by operating activities   | <u>199,428</u>         | <u>248,890</u>   | <u>199,943</u>   |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>                                       |                        |                  |                  |
| Property additions  | (123,129)              | (133,263)        | (176,918)        |
| Proceeds from property disposals  | 53                     | 544              | 157              |
| Purchase of marketable securities   | (95,825)               | (941,250)        | (213,700)        |
| Sale of marketable securities   | 120,625                | 916,450          | 213,700          |
| Net cash used in investing activities   | <u>(98,276)</u>        | <u>(157,519)</u> | <u>(176,761)</u> |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>                                       |                        |                  |                  |
| Repayment of long-term debt   | (428)                  | (400)            |                  |
| Cash dividends paid on preferred stock of subsidiary                              | (25)                   | (25)             | (25)             |
| Proceeds from issuance of common stock  | 16,105                 | 12,871           | 7,489            |
| Purchase of treasury stock  | (73,234)               | (45,318)         |                  |
| Changes in book overdrafts  | (6,964)                | (11,661)         | 15,391           |
| Net cash provided by (used in) financing activities                               | <u>(64,546)</u>        | <u>(44,533)</u>  | <u>22,855</u>    |



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|  |            |            |           |
|--|------------|------------|-----------|
| Net increase in cash and cash equivalents            | 36,606     | 46,838     | 46,037    |
| Cash and cash equivalents at beginning of year       | 125,558    | 78,720     | 32,683    |
| Cash and cash equivalents at end of year             | \$ 162,164 | \$ 125,558 | \$ 78,720 |
| Supplemental cash flow information:                  |            |            |           |
| Interest paid, net of capitalized interest           | \$ 465     | \$ 596     | \$ 166    |
| Income taxes paid                                    | 91,734     | 63,145     | 26,990    |
| Noncash financing and investing activities:          |            |            |           |
| Treasury stock issued for compensation plans         | \$ 27,256  | \$ 35,373  | \$ 18,112 |
| Debt assumed in connection with real estate purchase |            |            | 4,025     |

The accompanying notes are an integral part of the financial statements.

## BJ S WHOLESALE CLUB, INC.

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

|   | Common Stock |        | Additional<br>Paid-in<br>Capital | Unearned<br>Compensation | Retained<br>Earnings | Treasury Stock |              | Total<br>Stockholders<br>Equity |
|---|--------------|--------|----------------------------------|--------------------------|----------------------|----------------|--------------|---------------------------------|
|   | Shares       | Amount |                                  |                          |                      | Shares         | Amount       |                                 |
| (In Thousands)                                  |              |        |                                  |                          |                      |                |              |                                 |
| Balance, February 1, 2003                       | 74,410       | \$ 744 | \$ 62,378                        | \$ (160)                 | \$ 861,692           | (5,126)        | \$ (183,851) | \$ 740,803                      |
| Net income                                      |              |        |                                  |                          | 102,866              |                |              | 102,866                         |
| Issuance of common stock                        |              |        | (9,510)                          | (114)                    |                      | 505            | 18,112       | 8,488                           |
| Cash dividends on preferred stock of subsidiary |              |        |                                  |                          | (25)                 |                |              | (25)                            |
| Compensation expense                            |              |        |                                  | 89                       |                      |                |              | 89                              |
| Balance, January 31, 2004                       | 74,410       | 744    | 52,868                           | (185)                    | 964,533              | (4,621)        | (165,739)    | 852,221                         |
| Net income                                      |              |        |                                  |                          | 114,401              |                |              | 114,401                         |
| Issuance of common stock                        |              |        | (15,041)                         | (3,116)                  |                      | 1,025          | 35,373       | 17,216                          |
| Cash dividends on preferred stock of subsidiary |              |        |                                  |                          | (25)                 |                |              | (25)                            |
| Purchase of treasury stock                      |              |        |                                  |                          |                      | (1,725)        | (45,318)     | (45,318)                        |
| Compensation expense                            |              |        |                                  | 672                      |                      |                |              | 672                             |
| Balance, January 29, 2005                       | 74,410       | 744    | 37,827                           | (2,629)                  | 1,078,909            | (5,321)        | (175,684)    | 939,167                         |
| Net income                                      |              |        |                                  |                          | 128,533              |                |              | 128,533                         |
| Issuance of common stock                        |              |        | (6,550)                          | (482)                    |                      | 839            | 27,256       | 20,224                          |
| Cash dividends on preferred stock of subsidiary |              |        |                                  |                          | (25)                 |                |              | (25)                            |
| Purchase of treasury stock                      |              |        |                                  |                          |                      | (2,535)        | (73,234)     | (73,234)                        |
| Compensation expense                            |              |        |                                  | 1,314                    |                      |                |              | 1,314                           |
| Balance, January 28, 2006                       | 74,410       | \$ 744 | \$ 31,277                        | \$ (1,797)               | \$ 1,207,417         | (7,017)        | \$ (221,662) | \$ 1,015,979                    |

The accompanying notes are an integral part of the financial statements.

**BJS WHOLESALE CLUB, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Summary of Accounting Policies**

*Basis of Presentation*

The consolidated financial statements of BJS Wholesale Club, Inc. ( BJS or the Company or we ) include the financial statements of all of the Company's subsidiaries, all of whose common stock is wholly owned by the Company.

*Fiscal Year*

Our fiscal year ends on the Saturday closest to January 31. The fiscal years ended January 28, 2006, January 29, 2005 and January 31, 2004 each included 52 weeks.

*Cash Equivalents and Marketable Securities*

We consider highly liquid investments with a maturity of three months or less at time of purchase to be cash equivalents. Investments with maturities exceeding three months are classified as marketable securities.

Our marketable securities, which consist of high-grade debt securities issued by state governmental agencies or their political subdivisions, are classified as available for sale and are recorded at cost, which approximates fair value.

*Accounts Receivable*

Accounts receivable consist primarily of credit card receivables and vendor rebates and allowances and are stated net of allowances for doubtful accounts of \$879,000 at January 28, 2006 and \$616,000 at January 29, 2005. The determination of the allowance for doubtful accounts is based on BJS's historical experience applied to an aging of accounts and a review of individual accounts with a known potential for write-off.

*Merchandise Inventories*

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Inventories are stated at the lower of cost, determined under the average cost method, or market. We recognize the write-down of slow-moving or obsolete inventory in cost of sales when such write-downs are probable and estimable. We recognize a reserve for inventory shrinkage for the period between physical inventories based on historical results of previous physical inventories, shrinkage trends or other judgments management believes to be reasonable under the circumstances.

### *Property and Equipment*

Property is depreciated by use of the straight-line method for financial reporting purposes. Buildings are depreciated over 33 1/3 years. Leasehold costs and improvements are amortized over the required lease term (which includes renewal periods that are reasonably assured) or their estimated useful life, whichever is shorter. Leasehold costs and improvements that are placed in service significantly after and not contemplated at or near the beginning of the lease term are amortized over the term that includes the required lease term and renewal periods that are reasonably assured or their estimated useful life, whichever is shorter. Furniture, fixtures and equipment are depreciated over three to ten years. Interest related to the development of buildings is capitalized to the extent that debt is incurred during the construction period.

Normal repairs and maintenance are expensed as incurred.

*Impairment of Long-lived Assets*

We review the realizability of our long-lived assets annually and whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. Current and expected operating results and cash flows and other factors are considered in connection with our reviews. For purposes of evaluating the recoverability of long-lived assets, the recoverability test is performed using undiscounted net cash flows of individual clubs and consolidated net cash flows for long-lived assets not identifiable to individual clubs. Impairment losses are measured as the difference between the carrying amount and the fair value of the impaired assets held for use.

We recorded pretax asset impairment charges of \$13,000 in 2005, \$2,387,000 in 2004 and \$2,342,000 in 2003 to write down leasehold improvements and certain fixtures and equipment to fair value at underperforming clubs that were projected to have future cash flow losses. The fair value of the assets was based primarily on past experience in disposing of similar assets. Asset impairment charges are included in selling, general and administrative expenses.

*Self-Insurance Reserves*

We are primarily self-insured for worker's compensation and general liability claims. Reported reserves for these claims are derived from estimated ultimate costs based upon individual claim file reserves and estimates for incurred but not reported claims.

*Revenue Recognition*

We recognize revenue from the sale of merchandise, net of estimated returns, at the time of purchase by the customer in the club. In the limited instances when the customer is not able to take delivery at the point of sale, revenue from the sale of merchandise is not recognized until title and risk of loss pass to the customer. Membership fee revenue is recognized on a straight-line basis over the life of the membership, which is typically twelve months.

In determining comparable club information, we include all clubs that were open for at least 13 months at the beginning of the period and were in operation during all of both periods being compared. However, if a club is in the process of closing, it is excluded from comparable clubs. We include relocated clubs and expansions in comparable clubs.

*Vendor Rebates and Allowances*

We receive various types of cash consideration from vendors, principally in the form of rebates based on purchasing or selling certain volumes of product; time-based rebates or allowances, which may include product placement allowances or exclusivity arrangements covering a predetermined period of time; price protection rebates and allowances for retail reductions on certain merchandise; and salvage allowances for product that is damaged, defective or becomes out-of-date. We recognize such vendor rebates and allowances based on a systematic and rational allocation of the cash consideration offered to the underlying transaction that results in progress by BJs toward earning the rebates and allowances, provided the amounts to be earned are probable and reasonably estimable. Otherwise, rebates and allowances are recognized only when predetermined milestones are met. We recognize product placement allowances as a reduction of cost of sales in the period in which we complete the arranged placement of the product. Time-based rebates or allowances are recognized as a reduction of cost of sales over the performance period on a straight-line basis. All other vendor rebates and allowances are realized as a reduction of cost of sales when the

merchandise is sold or otherwise disposed.

We also receive cash consideration from vendors for demonstrating their products in the clubs and for advertising their products, particularly in the *BJ's Journal*, a publication sent to BJ's members throughout the year. In both cases, such cash consideration is recognized as a reduction of selling, general and administrative

( SG&A ) expenses to the extent it represents a reimbursement of specific, incremental and identifiable SG&A costs incurred by BJs to sell the vendors' products. If the cash consideration exceeds the costs being reimbursed, the excess is characterized as a reduction of cost of sales. Cash consideration for product demonstrations is recognized in the period during which the demonstrations are performed. Cash consideration for advertising vendors' products is recognized in the period in which the advertising takes place.

#### *Manufacturers' Incentives Tendered by Consumers*

At the beginning of 2004, we adopted the provisions of EITF Issue No. 03-10, Application of EITF Issue No. 02-16 by Resellers to Sales Incentives Offered to Consumers by Manufacturers ( EITF 03-10 ), which provides guidance for the reporting of vendor consideration received by a reseller as it relates to manufacturers' incentives (such as rebates or coupons) tendered by consumers. We include such vendor consideration in revenues only if all of the criteria defined in EITF 03-10 are met. Otherwise, such consideration is recorded as a decrease in cost of sales.

#### *Rent Expenses*

Rent expense for operating leases is recognized on a straight-line basis over the term of the leases. We begin recognizing rent expense in the preopening period when we take possession of the club. Our owned buildings, including those located on leased land, are depreciated on a straight-line basis over 33 1/3 years. We calculate rent for ground leases over periods that equal or exceed the time periods for depreciation of the buildings, which would include reasonably assured lease renewal periods.

#### *Preopening Costs*

Preopening costs consist of direct incremental costs of opening or relocating a facility and are charged to operations as incurred.

#### *Advertising Costs*

Advertising costs generally consist of promoting new memberships and new store openings and also include during the holiday season television and radio advertising (some of which is vendor-funded). BJs' expenses advertising costs as incurred. Advertising expenses were less than 0.40% of total sales in each of the last three years.

#### *Legal Costs*

Legal costs expected to be incurred in connection with a loss contingency are recognized at the same time that the loss contingency is recorded.

#### *Stock-Based Compensation*

As of January 28, 2006, we had two stock-based employee compensation plans, which are described more fully in Note H. We account for those plans under the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related Interpretations. No stock-based employee compensation cost for stock options is reflected in net income, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of the grant. We do include stock-based employee compensation cost for restricted stock in net income. The following table illustrates the effect on net income and earnings per share if we had applied the fair value recognition provisions of Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation, to stock-based employee compensation.



|   | Fiscal Year Ended            |                     |                     |
|---|------------------------------|---------------------|---------------------|
|   | January 28,<br>2006          | January 29,<br>2005 | January 31,<br>2004 |
|   | (Dollars in Thousands except |                     |                     |
|   | Per Share Amounts)           |                     |                     |
| Net income, as reported   | \$ 128,533                   | \$ 114,401          | \$ 102,866          |
| Add: Stock-based employee compensation expense included in reported net income, net of related tax effects                                  | 800                          | 412                 | 55                  |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects | (9,515)                      | (7,725)             | (4,439)             |
| Pro forma net income  | \$ 119,818                   | \$ 107,088          | \$ 98,482           |
| Earnings per share:   |                              |                     |                     |
| Basic as reported   | \$ 1.89                      | \$ 1.64             | \$ 1.48             |
| Basic pro forma   | \$ 1.76                      | \$ 1.54             | \$ 1.42             |
| Diluted as reported   | \$ 1.87                      | \$ 1.63             | \$ 1.47             |
| Diluted pro forma   | \$ 1.74                      | \$ 1.54             | \$ 1.42             |

*Disclosures about Fair Value of Financial Instruments*

The carrying amount of cash and cash equivalents and marketable securities approximates fair value because of the short maturity of these instruments. The carrying amount of marketable securities approximates fair value because of their interest rate reset feature, which typically adjusts to market rates every 35 days.

The carrying amount of long-term debt, including current installments, was \$3,197,000 and \$3,625,000 as of January 28, 2006 and January 29, 2005, respectively. The fair value of this debt was \$3,342,000 and \$3,920,000 as of January 28, 2006 and January 29, 2005, respectively. Fair value was based on our estimate of current rates on debt with similar remaining maturities for companies with credit ratings similar to BJs.

*Recently Issued Accounting Standards*

The Financial Accounting Standards Board ( FASB ) issued the following standards which become effective in 2006:

Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment, (SFAS 123 (R)) revises FASB Statement No. 123, Accounting for Stock-Based Compensation and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees, and its related implementation guidance.

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This statement establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services, and focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions.

Through 2005, we accounted for stock-based employee compensation under the recognition and measurement principles of APB Opinion No. 25. In accordance with that standard, no stock-based employee compensation cost for stock options has been reflected in our statements of income. In accordance with the provisions of the original SFAS No. 123, we have disclosed, on a pro forma basis, the effect on net income had we applied the provisions of that statement to stock-based employee compensation.

SFAS No. 123(R) requires us to recognize stock option expense in our statements of income beginning in the first fiscal quarter of 2006 and to estimate the effect of stock option forfeitures. (Through 2005, as permitted by the original SFAS No. 123, we have accounted for forfeitures as they occur.) In addition, SFAS 123(R) amends FASB Statement No. 95, Statements of Cash Flows, to require that excess tax benefits be reported as a financing cash inflow rather than as a reduction of taxes paid.

As of the beginning of our first fiscal quarter in 2006 (the required effective date), we will apply the provisions of SFAS 123(R) to new stock awards and to awards modified, repurchased or canceled after the required effective date. Additionally, compensation cost for the portion of awards for which the requisite service has not been rendered that are outstanding as of the required effective date shall be recognized as the service is rendered on or after that date. The compensation cost for that portion of awards will be based on the fair value of those awards as calculated for pro forma disclosure purposes under the original SFAS No. 123.

We estimate that stock option expense in 2006 will be approximately \$10 to \$12 million post-tax. The actual amount of stock option expense may vary materially from this estimate, due to certain factors, including number of options that will actually be issued, the timing of option grants, and the market price of our stock on the date of grant. We intend to apply the modified retrospective application transition method.

Most of BJS stock option awards specify that eligible participants whose employment terminates on or after their normal retirement date (as defined) may exercise options within the period of one year following their termination. Shares shall continue to become exercisable during this period in accordance with the stock option agreement. Notwithstanding the foregoing, options shall in no event be exercisable after the final exercise date. For pro forma reporting purposes under SFAS No. 123, we recognize compensation cost for this type of arrangement over the nominal vesting period (the nominal vesting period approach). Issue 19 of Emerging Issues Task Force Issue No. 00-23, Issues Related to the Accounting for Stock Compensation under APB 25 and FIN 44, (EITF 00-23) and paragraph 27 of SFAS 123 specify that an award is vested when the employee's retention of the award is no longer contingent on providing subsequent service (the non-substantive vesting period approach).

We will continue to follow the nominal vesting period approach for any new awards granted prior to adopting SFAS 123(R) and for the remaining portion of unvested outstanding awards. Upon adopting SFAS 123(R), we will apply the non-substantive vesting approach described in paragraphs A57-58 of SFAS 123(R) to new grants that have retirement eligibility provisions. Applying the non-substantive vesting approach instead of the nominal vesting approach would have increased post-tax stock option expense by approximately \$1.2 million in 2005, \$1.0 million in 2004 and \$0.8 million in 2003.

Statement of Financial Accounting Standards No. 151, Inventory Costs, amends the guidance in ARB No. 43, Chapter 4, Inventory Pricing, to clarify that abnormal amounts of idle facility expense, freight, handling costs, and spoilage should be recognized as current-period charges. The provisions of SFAS No. 151 become effective for BJS at the beginning of 2006. We believe that the adoption of SFAS No. 151 will not have a material effect on our results of operations, financial position or cash flows.

SFAS No. 154, Accounting Changes and Error Corrections—a replacement of APB Opinion No. 20 and SFAS No. 3, requires retrospective application to prior periods financial statements of changes in accounting principle, unless it is impracticable to do so. When it is impracticable to determine the effect on all prior periods, this statement requires that the new principle be applied to the earliest period practicable. This statement carries forward without change the guidance in APB Opinion No. 20 for reporting the correction of an error in previously issued financial statements and a change in accounting estimates. SFAS No. 154 shall be effective for accounting changes and corrections of errors made in fiscal years beginning in 2006. We expect that adoption of SFAS No. 154 will not have a material impact on our financial statements.

#### *Estimates Included in Financial Statements*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.



**A. Accounting Principle Change**

During the first quarter of 2003, we adopted the provisions of Statement of Financial Accounting Standards No. 143, Accounting for Asset Retirement Obligations ( SFAS No. 143 ). SFAS No. 143 requires us to recognize future costs for asset retirements to be incurred. We recorded a post-tax charge of \$1,253,000 (after reduction for income taxes of \$776,000), or \$.02 per diluted share, to reflect the cumulative effect of adopting this accounting principle change as of the beginning of the fiscal year, primarily in connection with the future removal of gasoline tanks from our gasoline stations.

The pro forma amounts shown at the bottom of the statements of income reflect net income and earnings per share as if SFAS No. 143 had been in effect during each period presented.

The following is a summary of activity relating to our liability for asset retirement obligations:

|                                  | Fiscal Year Ended      |                     |                     |
|----------------------------------|------------------------|---------------------|---------------------|
|                                  | January 28,<br>2006    | January 29,<br>2005 | January 31,<br>2004 |
|                                  | (Dollars in Thousands) |                     |                     |
| Balance, beginning of year       | \$ 10,640              | \$ 9,683            | \$                  |
| Liabilities incurred during year | 711                    | 302                 | 9,110 *             |
| Accretion expense                | 731                    | 655                 | 573                 |
| Balance, end of year             | \$ 12,082              | \$ 10,640           | \$ 9,683            |

\* Includes \$8,103,000 of liabilities recorded in connection with adopting SFAS No.143.

**B. Spin-off of the Company from Waban Inc. and Related Party Transactions**

The Company, which previously had been a wholly owned subsidiary of Waban Inc. ( Waban ), became a separate and independent public entity on July 28, 1997, when Waban distributed to its stockholders on a pro rata basis all of the Company's outstanding common stock (the spin-off ).

Pursuant to the spin-off, BJS and Waban entered into a Tax Sharing Agreement to provide for the payment of taxes and the entitlement to tax refunds for periods prior to the spin-off date. Each party has agreed to indemnify the other in specified circumstances if certain events occurring after July 28, 1997 cause the spin-off or certain related transactions to become taxable.

**C. Gain or Loss on Contingent Lease Obligations and Discontinued Operations**

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In connection with the spin-off of Waban by The TJX Companies, Inc. ( TJX ) in 1989, Waban and TJX entered into an agreement pursuant to which Waban agreed to indemnify TJX against any liabilities that TJX might incur with respect to 41 House2Home leases as to which TJX was either a lessee or guarantor. Pursuant to a subsequent agreement, BJ s agreed to indemnify TJX for 100% of House2Home s lease liabilities through January 31, 2003 and for 50% of any such liabilities thereafter.

House2Home filed for bankruptcy under Chapter 11 of the United States Bankruptcy Code on November 7, 2001. In 2001, we recorded a pretax charge of \$105.0 million for our estimated loss associated with House2Home leases. On a post-tax basis, this charge was \$63.0 million.

Based on our continuing evaluation of our remaining obligations and our success in settling liabilities for House2Home leases, we recorded pretax gains of \$0.1 million in 2005, \$2.7 million in 2004 and \$5.5 million in 2003 to reduce our estimated liability related to House2Home contingent lease obligations.

On November 9, 2002, we closed both of our clubs in the Columbus, Ohio, market and an older non-prototypical club in North Dade, Florida. The operating results of these clubs are presented in discontinued operations in the statements of income for all periods presented. In 2002, we recorded pretax club closing costs of \$21,387,000 (\$12,832,000 post-tax) and pretax operating losses of \$3,405,000 (\$2,111,000 post-tax). There were no revenues after 2002.

In the second quarter of 2005, we settled the lease for one of the closed BJ's clubs through a lump sum settlement. The settlement was consistent with the amount which we had reserved for this club. Loss from discontinued operations in 2005 consisted entirely of interest accretion charges of \$514,000 pretax (\$309,000 post-tax). In 2004, we made a lump sum payment to settle the lease for one of the clubs that closed in 2002. Based on the settlement and an evaluation of the status of the two remaining clubs, we recorded a pretax charge of \$2,853,000 to increase our reserve for closed clubs. Including pretax accretion charges of \$785,000, the pretax loss from discontinued operations totaled \$3,638,000 in 2004. On a post-tax basis, this loss was \$2,183,000. Loss from discontinued operations in 2003 consisted of pretax accretion charges of \$946,000 and an increase in the reserves of \$180,000 for the write-off of additional long-lived assets. On a post-tax basis, these charges amounted to \$676,000.

The following is a summary of activity relating to our obligations for House2Home and BJ's closed store leases:

|  | Fiscal Year Ended      |                     |                     |
|--|------------------------|---------------------|---------------------|
|  | January 28,<br>2006    | January 29,<br>2005 | January 31,<br>2004 |
|  | (Dollars in Thousands) |                     |                     |
| Reserves for closed store liabilities, beginning of year | \$ 15,991              | \$ 21,911           | \$ 58,334           |
| Provision for increase (decrease) to reserves            | (110)                  | 203                 | (5,320)             |
| Interest accretion charges                               | 514                    | 977                 | 1,958               |
| Cash payments  | (7,441)                | (7,100)             | (33,061)            |
| Reserves for closed store liabilities, end of year       | \$ 8,954               | \$ 15,991           | \$ 21,911           |

As of January 28, 2006, we have settled all 41 House2Home leases for which we were originally contingently liable, including lump sum settlements for 38 leases. The other three House2Home properties (for which we remain contingently liable) have been assigned to third parties. Two of the leases for the three BJ's clubs closed in November 2002 have been settled. We have reserved a total of \$8,954,000 associated with our obligations for the remaining lease as of January 28, 2006.

We believe that the liabilities recorded in the financial statements adequately provide for this lease obligation. However, there can be no assurance that our actual liability for the closed store obligation will not differ materially from amounts recorded in the financial statements due to a number of factors, including future economic factors which may affect the ability to successfully sublease, assign or otherwise settle liabilities related to this property. We consider our maximum reasonably possible undiscounted pretax exposure for our closed store lease obligations to be approximately \$21 million at January 28, 2006.

#### D. Debt

As of January 28, 2006, long-term debt, less the portion due within one year, consisted entirely of real estate debt, bearing interest at 7%, maturing through November 1, 2011. The real estate debt has a prepayment penalty. The aggregate maturities of long-term debt outstanding at January 28, 2006 were as follows:

| Fiscal Years Ending | Dollars in<br>Thousands |
|---------------------|-------------------------|
| _____               | _____                   |

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|                  |                 |
|------------------|-----------------|
| February 2, 2008 | \$ 493          |
| January 31, 2009 | 529             |
| January 30, 2010 | 567             |
| January 29, 2011 | 608             |
| Later years      | 540             |
| Total            | <u>\$ 2,737</u> |

Real estate debt was collateralized by land and buildings with a net book value of \$9,826,000.



On April 28, 2005, we entered into a new \$225 million unsecured credit agreement with a group of banks which expires April 27, 2010. The new agreement includes a \$50 million sub-facility for letters of credit, of which \$2.3 million was outstanding at January 28, 2006. We are required to pay an annual facility fee which is currently 0.15% of the total commitment. Interest on borrowings is payable at BJS's option either at (a) the Eurodollar rate plus a margin which is currently 0.475% or (b) a rate equal to the higher of (i) the sum of the Federal Funds Effective Rate plus 0.50% or (ii) the agent bank's prime rate. We are also required to pay a usage fee whenever the amount of loans and undrawn or unreimbursed letters of credit outstanding exceeds 50% of the total commitment. The usage fee, if applicable, would be at an annual rate of 0.125% of the amount borrowed. The facility fee and Eurodollar margin are subject to change based upon our fixed charge coverage ratio. The agreement contains financial covenants which include a minimum fixed charge coverage requirement and a maximum adjusted debt to capital limitation. We are required to comply with these covenants on a quarterly basis. Under the credit agreement, we may pay dividends or repurchase our own stock in any amount so long as we remain in compliance with all requirements under the agreement. We have no credit rating triggers that would accelerate the maturity date of debt if borrowings were outstanding under our credit agreement. We were in compliance with the covenants and other requirements set forth in our credit agreement at January 28, 2006.

In addition to the credit agreement, we maintain a separate \$62 million facility for letters of credit, primarily to support the purchase of inventories, of which \$36.6 million was outstanding at January 28, 2006, and also maintain a \$25 million uncommitted credit line for short-term borrowings which expires on September 30, 2006.

There were no borrowings outstanding under our bank credit agreement or our uncommitted credit line at January 28, 2006 and January 29, 2005.

#### E. Commitments and Contingencies

We are obligated under long-term leases for the rental of real estate. In addition, we are generally required to pay insurance, real estate taxes and other operating expenses and, in some cases, additional rentals based on a percentage of sales in excess of certain amounts, or other factors. Many of our leases require escalating payments during the lease term. Rent expense for such leases is recognized on a straight-line basis over the lease term. The initial primary term of our real estate leases (excluding ground leases) ranges from 4 to 25 years. Most of these leases have an initial term of 20 years. The initial primary term of our ground leases ranges from 15 to 44 years, and averages approximately 25 years. As of January 28, 2006, we have options to renew all but one of our leases for periods that range from 5 to 50 years, and average approximately 21 years. Future minimum lease payments as of January 28, 2006 were:

| <b>Fiscal Years Ending</b> | <b>Dollars in<br/>Thousands</b> |
|----------------------------|---------------------------------|
| February 3, 2007           | \$ 129,550                      |
| February 2, 2008           | 133,459                         |
| January 31, 2009           | 136,661                         |
| January 30, 2010           | 139,137                         |
| January 29, 2011           | 137,408                         |
| Later years                | 1,570,871                       |
| <b>Total</b>               | <b>\$ 2,247,086</b>             |

We corrected our methods of accounting related to the timing of rent expense recognition at our leased locations, and for recognizing rent expenses for certain of our ground leases, in the fourth quarter of 2004. As a result of these changes, we recorded cumulative, non-cash charges of \$5.8 million to begin recognizing rent expenses when we take possession of our clubs, and \$1.4 million to adjust rent for our ground leases, in the fourth quarter of 2004. Of the \$7.2 million recorded for these charges, \$475,000 was related to 2004 and the remainder is related to prior

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years. The effect of this adjustment was to increase preopening expenses by \$8.2 million and to decrease cost of sales, including buying and occupancy costs, by \$1.0 million. See [Summary of Accounting Policies](#) [Property and Equipment and Rent Expenses](#) for additional information.

Financial results for prior periods were not restated due to the immateriality of these issues to the results of operations and statements of financial position for the current year and each prior year. These charges will not affect historical or future cash flows, nor will they affect the timing or amounts of payments for the related leases.

The payments above do not include future payments due under the lease for one BJ's club which was closed in November 2002. Rent liabilities for the closed club is included in the balance sheet (see Note C for additional information).

Rental expense under operating leases (including contingent rentals, which were not material) amounted to \$120,197,000, \$114,984,000 and \$102,735,000 in 2005, 2004 and 2003, respectively. Rental expense in 2004 included corrections to our accounting for leases of \$7.2 million, \$6.7 million of which was related to prior years.

We are involved in various legal proceedings that are typical of a retail business. Although it is not possible to predict the outcome of these proceedings or any related claims, we believe that such proceedings or claims will not, individually or in the aggregate, have a material adverse effect on our financial condition or results of operations.

BJ's has filed proofs of claim against House2Home, Inc. for claims arising under certain agreements between BJ's and House2Home in connection with the Company's spin-off from Waban Inc. in July 1997. These claims arise primarily from BJ's indemnification of TJX with respect to TJX's guarantee of House2Home leases and from the Tax Sharing Agreement dated July 28, 1997 between BJ's and House2Home. House2Home and BJ's have settled BJ's claims against House2Home. The settlement provides that BJ's will have an unsecured claim of approximately \$38 million, on account of claims under the Tax Sharing Agreement and indemnification payments which have been made to TJX. The settlement agreement was approved by the United States Bankruptcy Court for the Central District of California on November 10, 2003. As part of the settlement, BJ's has been released of all claims that House2Home and its bankruptcy estate may have had against BJ's, including \$1.7 million owed by BJ's to House2Home under the Tax Sharing Agreement. We recognized this amount as a reduction in our tax provision in the fourth quarter of 2003.

During 2005, we received pretax recoveries on account of our House2Home bankruptcy claims of \$4.4 million. These recoveries are recorded in gain on contingent lease obligations in the statement of income. On a post-tax basis, these gains totaled \$3.0 million.

During 2004, we received pretax recoveries on account of our House2Home bankruptcy claims totaling \$7.0 million, including a payment of \$2.5 million to settle our claim against the Indenture Trustee for House2Home's Convertible Subordinated Notes. We have no further claims against the Indenture Trustee. These recoveries are also included in gain on contingent lease obligations in the statements of income. On a post-tax basis these gains totaled \$4.6 million.

In March 2006, we received bankruptcy recoveries of \$3.1 million on account of our House2Home bankruptcy claims. On a post-tax basis, these gains were \$2.1 million. The Bankruptcy Court has closed our case and we do not expect to receive further payments on our claims. The recoveries that we received in March 2006 will be recorded in the first quarter of the fiscal year ending February 3, 2007.

As permitted by Delaware law, BJ's has entered into agreements whereby it indemnifies its directors and officers for certain events or occurrences while the director or officer is or was serving, at the Company's request, in such capacity. The maximum potential amount of future payments that BJ's could be required to make under these agreements is not limited. However, BJ's carries directors' and officers' insurance that covers its exposure up to certain limits. As a result of our insurance coverage, we believe that the estimated fair value of our indemnification agreements with directors and officers is minimal. No liabilities have been recorded for these agreements as of January 28, 2006.



In 2002, we began to offer an extended warranty on tires sold at our clubs, under which BJ's customers receive tire repair services or tire replacement in certain circumstances. We have insured this liability through a third party and, therefore, retain no liability in connection with the tire warranty program other than for the premiums paid to the third-party carrier.

#### **F. Provision for Credit Card Claims**

Early in 2004 we were notified by credit card issuers that credit and debit card accounts used legitimately at BJ's were subsequently used in fraudulent transactions at non-BJ's locations. In response, we retained a leading computer security firm to conduct a forensic analysis of our information technology systems with a goal of determining whether a breach had in fact occurred. While no conclusive evidence of a breach was found, the computer security firm concluded that: (1) our centralized computer system that serves as the aggregation point for all BJ's credit and debit card transactions chain-wide had not been breached and (2) any breach would have likely occurred in a more decentralized fashion involving club-level systems. On March 12, 2004, after our receipt of the computer security firm's preliminary report of findings, we issued a public statement alerting consumers to the potential security breach.

In 2004, we recorded charges of \$7.0 million (\$4.2 million post-tax) to establish a reserve for claims seeking reimbursement for fraudulent credit and debit card charges and the cost of replacing cards, monitoring expenses and related fees and expenses.

In 2005, we recorded additional charges of \$4.0 million (\$2.4 million post-tax) to increase our reserve. These charges were driven primarily by an increase in our estimate of legal costs to be incurred in connection with this matter. As of January 28, 2006, the balance in the reserve was \$4.5 million, which represented our best estimate of the remaining cost and expenses related to this matter at that time. This reserve is included in accrued expenses and other current liabilities on our balance sheet.

In connection with this matter, on September 20, 2005 the Company entered into a consent decree with the Federal Trade Commission (FTC), which has jurisdiction over consumer protection matters. The full text of the consent decree can be found on the FTC's website. In summary, BJ's has not admitted any wrongdoing or that the facts alleged in the FTC's complaint are true. Under the consent decree, BJ's will pay no fines or damages. BJ's has agreed, however, to maintain a comprehensive information security program, much of which was put in place shortly after BJ's first learned of the possible compromise, and to a biannual assessment of that program by an independent third party.

As of March 31, 2006, the amount of outstanding claims, which are primarily from credit card issuing banks, was approximately \$13 million. We are unable to predict whether further claims will be asserted. We have contested and will continue to vigorously contest the claims made against us and continue to explore our defenses and possible claims against others.

The ultimate outcome of this matter could differ from the amounts recorded. While that difference could be material to the results of operations for any affected reporting period, it is not expected to have a material impact on our consolidated financial position or liquidity.

#### **G. Capital Stock**

During 2005, the Board of Directors authorized the repurchase of an additional \$100 million of the Company's common stock in addition to the \$400 million previously authorized. We repurchased 2,535,600 shares of our common stock for \$73,233,898 in 2005 and 1,725,200 shares for \$45,318,000 in 2004. We did not repurchase any stock in 2003. As of January 28, 2006, the Company's remaining repurchase authorization was

\$71,905,000.

BJ s has a shareholder rights plan, originally adopted in 1997 and amended in 1999 (and in 2003 solely to appoint a new rights agent), pursuant to which shareholders are issued one-half of a Right for each share of

common stock. Each Right entitles the holder to purchase from the Company 1/1000 share of Series A Junior Participating Preferred Stock ( Series A Preferred Stock ) at a price of \$120. BJ s has designated 100,000 shares of Series A Preferred Stock for issuance under the shareholder rights plan; none has been issued to date. Generally, the terms of the Series A Preferred Stock are designed so that 1/1000 share of Series A Preferred Stock is the economic equivalent of one share of BJ s common stock. The Rights are exercisable only if a person acquires 20% or more of the Company s common stock or commences a tender offer that would result in such person owning 30% or more of the Company s common stock. In addition, in general, if after a person has become a 20% owner, BJ s is involved in a business combination transaction in which it is not the surviving corporation or in connection with which the BJ s common stock is changed, or BJ s disposes of 50% or more of its assets or earning power, each Right that has not previously been exercised or voided will entitle its holder to purchase that number of shares of common stock of such other person which equals \$120 divided by one-half of the then current market price of such common stock. BJ s will generally be entitled to redeem the Rights at \$.01 per Right at any time until the tenth business day following public announcement that a person has become a 20% owner. The Rights expire on July 10, 2007, unless earlier redeemed or exchanged.

The Company has authorized 20,000,000 shares of preferred stock, \$.01 par value, of which no shares have been issued.

In December 1997, one of BJ s subsidiaries issued 126 shares of non-voting preferred stock to individual stockholders at \$2,200 per share. These shares are each entitled to receive ongoing annual dividends of \$200 per share. The minority interest in this subsidiary is equal to the preferred shares preference in an involuntary liquidation of \$277,200 and is included in other noncurrent liabilities in our consolidated balance sheets at January 28, 2006 and January 29, 2005.

#### **H. Stock Incentive Plans**

Under its 1997 Stock Incentive Plan, BJ s has granted certain key employees and directors options to purchase common stock at prices equal to 100% of market price on the grant date. These options, which generally expire ten years from the grant date, are generally exercisable 25% per year starting one year after the grant date. Options granted to non-employee directors expire ten years from the grant date, but are exercisable in three equal annual installments beginning on the first day of the month which includes the first anniversary of the date of grant. At the Company s Annual Meeting of Stockholders in May 2004, an amendment to increase the maximum number of shares issuable under the 1997 Stock Incentive Plan by 4,000,000 shares was approved. Certain sub-limits were also approved for awards from and after the date of the 2004 Annual Meeting of Stockholders, including a limit of 1,000,000 shares with respect to awards other than options and stock appreciation rights and a limit of 300,000 shares with respect to awards granted to non-employee directors. The maximum number of shares of common stock issuable under this plan is now 11,249,402 shares, plus shares subject to awards granted under the BJ s Wholesale Club, Inc. 1997 Replacement Stock Incentive Plan (the Replacement Plan ) which are not actually issued because such awards expire or are canceled. Under the Replacement Plan, BJ s employees who held Waban stock options and restricted stock were granted replacement BJ s options and restricted stock, which preserved the same inherent value, vesting terms and expiration dates as the Waban awards they replaced in connection with the spin-off. No new options could be granted under the Replacement Plan after January 28, 1998.

At the 2003 Annual Meeting of Stockholders of the Company held on May 22, 2003, the Company s stockholders approved an amendment to BJ s 1997 Stock Incentive Plan to permit a stock option exchange program under which outstanding stock options having an exercise price greater than \$29.00 per share would be exchanged for new options. The new options would be exercisable for one-half the number of shares of exchanged options and would have an exercise price equal to the fair market value of BJ s common stock on the date of the grant, which would be at least six months and one day after cancellation of the exchanged options. BJ s directors, President/Chief Executive Officer and Executive Vice Presidents were not eligible to participate in the program.

On May 27, 2003, the expiration date of the Company s exchange offer, the Company accepted for exchange from eligible employees options to purchase an aggregate of 1,307,385 shares of BJ s common stock.





These stock options were cancelled as of that date. On November 28, 2003, the Company issued new options to purchase 646,054 shares of BJS common stock in exchange for the options surrendered in the offer. The exercise price of these new options is \$25.45, which was equal to the fair market value of BJS common stock on November 28, 2003. None of the new options vested or became exercisable until May 28, 2004. Beginning on May 28, 2004, the new options immediately vested to the same extent that the options they replaced would have been vested on that date had they not been surrendered. After May 28, 2004, the new options have the same vesting schedule and the same remaining term as the options they replaced.

As of January 28, 2006 and January 29, 2005, respectively, 1,896,691 and 2,763,385 shares were reserved for all future stock awards under BJS stock incentive plans. As of January 28, 2006 and January 29, 2005, respectively, of the total shares reserved, a maximum of 847,000 and 862,500 shares were reserved for awards other than options and stock appreciation rights, and a maximum of 220,000 and 255,000 shares were reserved for awards for non-employee directors.

We apply APB 25 and related Interpretations in accounting for our stock-based compensation. Total pretax compensation cost recognized in the statements of income for stock-based employee compensation awards was \$1,314,000 in 2005, \$672,000 in 2004 and \$89,000 in 2003, and consisted entirely of restricted stock expense, which is charged to income ratably over the periods during which the restrictions lapse. 23,000 shares of restricted stock were issued in 2005 at a weighted-average grant date value of \$29.28; 137,500 shares of restricted stock were issued in 2004 at a weighted-average grant date value of \$22.66; and 5,000 shares of restricted stock were issued in 2003 at a weighted-average grant date value of \$22.82. Restricted shares granted in the last three years were issued at no cost and have a service condition only. 7,500 restricted shares were returned to the Company's treasury in 2005. No compensation cost has been recognized under APB 25 for BJS stock options because the exercise price equaled the market price of the underlying stock on the date of grant.

The table that follows illustrates the effect on net income and earnings per share if we had applied the fair value recognition provisions of Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation, to stock-based employee compensation, including stock options. The fair value for stock options was estimated at the grant date using the Black-Scholes option pricing model with the following weighted-average assumptions: risk-free interest rates of 3.73%, 3.46% and 2.95%, in 2005, 2004 and 2003, respectively; volatility factor of the expected market price of BJS common stock of .38 in 2005 and .46 in 2004 and 2003; and expected life of the options of 5 years in 2005, 4.9 years in 2004 and 4.6 years in 2003. No dividends were expected. The weighted-average fair value of options granted was \$11.67 in 2005, \$11.18 in 2004, and \$9.37 in 2003. For purposes of pro forma disclosure, the estimated fair value of the options is amortized to expense over the options vesting period and forfeitures are recognized when they occur.

|   | Fiscal Year Ended                               |             |             |
|---|---|-------------|-------------|
|   | January 28,                                     | January 29, | January 31, |
|   | 2006  | 2005        | 2004        |
|   | (Dollars in Thousands except Per Share Amounts) |             |             |
| Net income, as reported   | \$ 128,533                                      | \$ 114,401  | \$ 102,866  |
| Add: Stock-based employee compensation expense included in reported net income, net of related tax effects                                  | 800   | 412         | 55          |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects | (9,515)   | (7,725)     | (4,439)     |
| Pro forma net income  | \$ 119,818                                      | \$ 107,088  | \$ 98,482   |
| Earnings per share:   |   |             |             |

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|                     |         |         |         |
|---------------------|---------|---------|---------|
| Basic as reported   | \$ 1.89 | \$ 1.64 | \$ 1.48 |
| Basic pro forma     | \$ 1.76 | \$ 1.54 | \$ 1.42 |
| Diluted as reported | \$ 1.87 | \$ 1.63 | \$ 1.47 |
| Diluted pro forma   | \$ 1.74 | \$ 1.54 | \$ 1.42 |

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.

Presented below is a summary of the status of stock option activity and weighted-average exercise prices for the last three fiscal years (number of options in thousands):

|                                | Fiscal Year Ended |                |                  |                |                  |                |
|--------------------------------|-------------------|----------------|------------------|----------------|------------------|----------------|
|                                | January 28, 2006  |                | January 29, 2005 |                | January 31, 2004 |                |
|                                | Options           | Exercise Price | Options          | Exercise Price | Options          | Exercise Price |
| Outstanding, beginning of year | 6,701             | \$ 24.37       | 6,030            | \$ 22.75       | 5,791            | \$ 26.03       |
| Granted                        | 1,442             | 29.92          | 1,718            | 25.40          | 2,354            | 22.30          |
| Exercised                      | (824)             | 19.56          | (888)            | 14.50          | (500)            | 14.98          |
| Forfeited                      | (591)             | 31.57          | (159)            | 29.12          | (1,615)          | 36.28          |
| Outstanding, end of year       | 6,728             | 25.52          | 6,701            | 24.37          | 6,030            | 22.75          |
| Exercisable, end of year       | 3,116             | 25.09          | 3,045            | 25.13          | 2,599            | 21.82          |

Additional information related to stock options outstanding at January 28, 2006 is presented below (number of options in thousands):

| Range of Exercise Prices | Options Outstanding |                                 |  | Options Exercisable |                                 |
|--------------------------|---------------------|---------------------------------|--|---------------------|---------------------------------|
|                          | Number Outstanding  | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Life (yrs.) | Number Exercisable  | Weighted-Average Exercise Price |
| \$ 9.45 - \$14.39        | 132                 | \$ 11.04                        | 1.4  | 123                 | \$ 10.77                        |
| \$15.01 - \$22.33        | 1,094               | 17.40                           | 5.5  | 563                 | 17.36                           |
| \$22.82 - \$31.40        | 5,064               | 26.46                           | 7.8  | 1,992               | 25.05                           |
| \$37.06 - \$47.60        | 438                 | 39.22                           | 4.9  | 438                 | 39.22                           |
| \$ 9.45 - \$47.60        | 6,728               | 25.52                           | 7.1  | 3,116               | 25.09                           |

## I. Earnings Per Share

The following details the calculation of earnings per share for the last three fiscal years:

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|   | <b>Fiscal Year Ended</b>    |                             |                             |
|---|-----------------------------|-----------------------------|-----------------------------|
|   | <b>January 28,<br/>2006</b> | <b>January 29,<br/>2005</b> | <b>January 31,<br/>2004</b> |
|   | (Dollars in Thousands)      |                             |                             |
|   | except Per Share Amounts)   |                             |                             |
| Income from continuing operations   | \$ 128,842                  | \$ 116,584                  | \$ 104,795                  |
| Less: Preferred stock dividends   | 25                          | 25                          | 25                          |
| <b>Income available to common stockholders</b>  | <b>\$ 128,817</b>           | <b>\$ 116,559</b>           | <b>\$ 104,770</b>           |
| Weighted-average number of common shares outstanding, used for basic computation          | 68,005,849                  | 69,580,978                  | 69,521,408                  |
| Plus: Incremental shares from conversion of stock options and restricted stock            | 749,622                     | 550,675                     | 293,612                     |
| <b>Weighted-average number of common and dilutive potential common shares outstanding</b> | <b>68,755,471</b>           | <b>70,131,653</b>           | <b>69,815,020</b>           |
| <b>Basic earnings per share</b>   | <b>\$ 1.89</b>              | <b>\$ 1.68</b>              | <b>\$ 1.51</b>              |
| <b>Diluted earnings per share</b>   | <b>\$ 1.87</b>              | <b>\$ 1.66</b>              | <b>\$ 1.50</b>              |

Options to purchase 1,789,700 shares at a weighted-average exercise price of \$32.39, 1,860,650 shares at a weighted-average exercise price of \$31.70 and 3,959,448 shares at a weighted-average exercise price of \$27.15 were outstanding at January 28, 2006, January 29, 2005 and January 31, 2004, respectively, but were not included in the computation of diluted earnings per share because the options' exercise price was greater than the average market price of the common shares for the years then ended.

**J. Income Taxes**

The provision for income taxes includes the following:

|   | Fiscal Year Ended      |                     |                     |
|---|------------------------|---------------------|---------------------|
|   | January 28,<br>2006    | January 29,<br>2005 | January 31,<br>2004 |
|   | (Dollars in Thousands) |                     |                     |
| Federal:                                |                        |                     |                     |
| Current                                 | \$ 73,652              | \$ 63,228           | \$ 33,325           |
| Deferred                                | (7,594)                | (4,090)             | 21,224              |
| State:                                  |                        |                     |                     |
| Current                                 | 14,415                 | 12,754              | 6,627               |
| Deferred                                | 1,602                  | (463)               | 915                 |
| <b>Total income tax provision</b>       | <b>\$ 82,075</b>       | <b>\$ 71,429</b>    | <b>\$ 62,091</b>    |
| Components of income tax provision:     |                        |                     |                     |
| Continuing operations                   | \$ 82,281              | \$ 72,884           | \$ 63,318           |
| Discontinued operations                 | (206)                  | (1,455)             | (451)               |
| Cumulative effect of accounting changes |                        |                     | (776)               |
|   | <b>\$ 82,075</b>       | <b>\$ 71,429</b>    | <b>\$ 62,091</b>    |

The following is a reconciliation of the statutory federal income tax rates and the effective income tax rates:

|  | Fiscal Year Ended      |                     |                     |
|--|------------------------|---------------------|---------------------|
|  | January 28,<br>2006    | January 29,<br>2005 | January 31,<br>2004 |
|  | (Dollars in Thousands) |                     |                     |
| Statutory federal income tax rates             | 35%                    | 35%                 | 35%                 |
| State income taxes, net of federal tax benefit | 5                      | 3                   | 3                   |
| Other  | (1)                    |                     |                     |
| <b>Effective income tax rates</b>              | <b>39%</b>             | <b>38%</b>          | <b>38%</b>          |



Significant components of the Company's deferred tax assets and liabilities as of January 28, 2006 and January 29, 2005 were as follows:

|  | January 28,<br>2006    | January 29,<br>2005 |
|--|------------------------|---------------------|
|  | (Dollars in Thousands) |                     |
| <b>Deferred tax assets:</b>                  |                        |                     |
| Closed store lease obligations               | \$ 3,582               | \$ 6,353            |
| Self-insurance reserves                      | 15,013                 | 14,391              |
| Rental step liabilities                      | 6,545                  | 9,177               |
| Compensation and benefits                    | 11,741                 | 10,834              |
| Other  | 27,543                 | 22,627              |
| <b>Total deferred tax assets</b>             | <b>64,424</b>          | <b>63,382</b>       |
| <b>Deferred tax liabilities:</b>             |                        |                     |
| Accelerated depreciation property            | 56,173                 | 62,634              |
| Property taxes                               | 4,355                  | 3,849               |
| Other  | 3,723                  | 3,632               |
| <b>Total deferred tax liabilities</b>        | <b>64,251</b>          | <b>70,115</b>       |
| <b>Net deferred tax assets (liabilities)</b> | <b>\$ 173</b>          | <b>\$ (6,733)</b>   |

We have not established a valuation allowance because our deferred tax assets can be utilized by offsetting deferred tax liabilities and future taxable income, which management believes will more likely than not be earned, based on our historical earnings record and projected future earnings.

#### K. Retirement Plans

Under BJS's 401(k) Savings plans, participating employees may make pretax contributions up to 50% of covered compensation, subject to statutory limits. BJS matches employee contributions at 100% of the first one percent of covered compensation and 50% of the next four percent. The Company's expense under these plans was \$4,903,000, \$4,177,000 and \$3,555,000 in 2005, 2004 and 2003, respectively.

We have a non-contributory defined contribution retirement plan for certain key employees. Under this plan, BJS funds annual retirement contributions for the designated participants on an after-tax basis. For the last three years, the Company's contributions equaled 5% of the participants' base salary. Participants become fully vested in their contribution accounts at the end of the fiscal year in which they complete four years of service. Our pretax expense under this plan was \$1,565,000, \$1,441,000 and \$1,179,000 in 2005, 2004 and 2003, respectively.

**L. Postretirement Medical Benefits**

We have a defined benefit postretirement medical plan which covers employees and their spouses who retire after age 55 with at least 10 years of service, who are not eligible for Medicare, and who participated in a Company-sponsored medical plan. Amounts contributed by retired employees under this plan are based on years of service prior to retirement. The plan is not funded. The discount rates presented in the tables below were selected by referencing yields on high quality corporate bonds, including Moody's Aa Corporate Bond Rate and the Citigroup Pension Yield Curve.

Net periodic postretirement medical benefit cost included the following components:

|   | Fiscal Year Ended      |                     |                     |
|---|------------------------|---------------------|---------------------|
|   | January 28,<br>2006    | January 29,<br>2005 | January 31,<br>2004 |
|   | (Dollars in Thousands) |                     |                     |
| Service cost                                    | \$ 542                 | \$ 420              | \$ 371              |
| Interest cost                                   | 250                    | 213                 | 166                 |
| Amortization of unrecognized loss               | 85                     | 60                  | 35                  |
| <b>Net periodic postretirement benefit cost</b> | <b>\$ 877</b>          | <b>\$ 693</b>       | <b>\$ 572</b>       |
| Discount rate used to determine cost            | 5.50%                  | 6.00%               | 6.25%               |

The following table sets forth the funded status of BJS's postretirement medical plan and the amount recognized in the balance sheets at January 28, 2006 and January 29, 2005:

|  | January 28,<br>2006    | January 29,<br>2005 |
|--|------------------------|---------------------|
|  | (Dollars in Thousands) |                     |
| Unfunded accumulated postretirement benefit obligation (APBO)                  | \$ 5,352               | \$ 4,346            |
| Unrecognized net loss  | (1,200)                | (1,037)             |
| <b>Accrued postretirement benefit cost included in balance sheets</b>          | <b>\$ 4,152</b>        | <b>\$ 3,309</b>     |
| Discount rate used to value APBO   | 5.50%                  | 5.50%               |
| Weighted-average health care cost trend rate for valuing year-end obligations: |                        |                     |
| Initial trend rate   | 9.00%                  | 10.00%              |
| Ultimate trend rate  | 5.00%                  | 5.00%               |
| Year ultimate trend rate to be attained  | 2010                   | 2010                |



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The following tables present reconciliations of the APBO and plan assets for the fiscal years ended January 28, 2006 and January 29, 2005:

|  | Fiscal Year Ended   |                     |
|--|---------------------|---------------------|
|  | January 28,<br>2006 | January 29,<br>2005 |
| (Dollars in Thousands)                         |                     |                     |
| Reconciliation of APBO:                        |                     |                     |
| APBO at beginning of year                      | \$ 4,346            | \$ 3,548            |
| Service cost                                   | 542                 | 420                 |
| Interest cost                                  | 250                 | 213                 |
| Contributions by plan participants             | 26                  | 19                  |
| Actuarial losses                               | 248                 | 166                 |
| Benefits paid                                  | (60)                | (20)                |
| APBO at end of year                            | <u>\$ 5,352</u>     | <u>\$ 4,346</u>     |
| Reconciliation of plan assets:                 |                     |                     |
| Fair value of plan assets at beginning of year | \$                  | \$                  |
| Employer contributions                         | 34                  | 2                   |
| Contributions by plan participants             | 26                  | 19                  |
| Benefits paid                                  | (60)                | (21)                |
| Fair value of plan assets at end of year       | <u>\$</u>           | <u>\$</u>           |

The following table sets forth the impact of changes in the assumed health care cost trend rates for the fiscal year ended January 28, 2006:

|   | Dollars in<br>Thousands |
|---|-------------------------|
| Impact of 1% increase in health care cost trend on: |                         |
| Aggregate of service and interest costs             | \$ 89                   |
| APBO at end of year                                 | 520                     |
| Impact of 1% decrease in health care cost trend on: |                         |
| Aggregate of service and interest costs             | \$ (79)                 |
| APBO at end of year                                 | (467)                   |

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

| Fiscal Year Ending | Dollars in<br>Thousands |
|--------------------|-------------------------|
| February 3, 2007   | \$ 55                   |
| February 2, 2008   | 84                      |
| January 31, 2009   | 112                     |
| January 30, 2010   | 138                     |

|                                       |       |
|---------------------------------------|-------|
| January 29, 2011                      | 190   |
| Fiscal years ending January 2012-2016 | 1,729 |

**M. Interest**

The following details the components of interest income (expense), net for the last three fiscal years:

|                                | Fiscal Year Ended      |                     |                     |
|--------------------------------|------------------------|---------------------|---------------------|
|                                | January 28,<br>2006    | January 29,<br>2005 | January 31,<br>2004 |
|                                | (Dollars in Thousands) |                     |                     |
| Interest income                | \$ 3,340               | \$ 1,638            | \$ 341              |
| Capitalized interest           | 142                    | 40                  | 328                 |
| Interest expense on debt       | (740)                  | (875)               | (743)               |
| Interest income (expense), net | \$ 2,742               | \$ 803              | \$ (74)             |

**N. VISA/MasterCard Settlement**

In April 2003, a settlement was reached in the VISA/MasterCard antitrust class action litigation. The terms of the settlement require VISA and MasterCard to pay \$3.05 billion into a settlement fund that will be distributed to class members. We are a member of the class and are entitled to a portion of the fund. During the third quarter of 2005, we received a settlement offer related to the distribution of the fund. Based upon information contained in the settlement offer, we recorded a \$3.1 million pretax estimated recovery as a reduction to selling, general and administrative expenses. On a post-tax basis, this recovery was \$1.9 million.

**O. Accounts Payable**

Our banking arrangements provide for the daily replenishment of vendor payable bank accounts as checks are presented. The balances of checks outstanding in these bank accounts totaling \$77,357,000 at January 28, 2006 and \$84,321,000 at January 29, 2005, which represent book overdrafts, are included in accounts payable on the balance sheets and the changes in these balances are reflected in financing activities in the statements of cash flows.

**P. Accrued Expenses and Other Current Liabilities**

The major components of accrued expenses and other current liabilities are as follows:

| January 28,<br>2006 | January 29,<br>2005 |
|---------------------|---------------------|
|---------------------|---------------------|

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|  | (Dollars in Thousands) |                   |
|--|------------------------|-------------------|
| Employee compensation  | \$ 43,013              | \$ 36,543         |
| Deferred membership fee income   | 68,398                 | 66,112            |
| Sales and use taxes, self-insurance reserves, rent, utilities, advertising and other | 141,164                | 136,256           |
|  | <u>\$ 252,575</u>      | <u>\$ 238,911</u> |

The following table summarizes membership fee activity for each of the last three fiscal years:

|   | Fiscal Year Ended      |                     |                     |
|---|------------------------|---------------------|---------------------|
|   | January 28,<br>2006    | January 29,<br>2005 | January 31,<br>2004 |
|   | <u>2006</u>            | <u>2005</u>         | <u>2004</u>         |
|   | (Dollars in Thousands) |                     |                     |
| Deferred membership fee income, beginning of year | \$ 66,112              | \$ 60,868           | \$ 56,251           |
| Cash received from members                        | 152,300                | 144,686             | 128,842             |
| Revenue recognized in earnings                    | (150,014)              | (139,442)           | (124,225)           |
| Deferred membership fee income, end of year       | <u>\$ 68,398</u>       | <u>\$ 66,112</u>    | <u>\$ 60,868</u>    |

**Q. Selected Quarterly Financial Data (Unaudited)**

|   | First<br>Quarter | Second<br>Quarter | Third<br>Quarter | Fourth<br>Quarter |
|---|------------------|-------------------|------------------|-------------------|
| (Dollars in Thousands except Per Share Amounts) |                  |                   |                  |                   |
| Fiscal year ended January 28, 2006 (b):         |                  |                   |                  |                   |
| Net sales                                       | \$ 1,768,789     | \$ 1,981,593      | \$ 1,922,181     | \$ 2,111,386      |
| Total revenues                                  | 1,809,550        | 2,022,538         | 1,964,328        | 2,153,518         |
| Gross earnings (a)                              | 173,569          | 206,060           | 195,319          | 251,293           |
| Net income                                      | 18,623           | 30,453            | 27,815           | 51,642            |
| Per common share, diluted                       | 0.27             | 0.44              | 0.41             | 0.76              |
| Fiscal year ended January 29, 2005 (c):         |                  |                   |                  |                   |
| Net sales                                       | \$ 1,610,958     | \$ 1,839,988      | \$ 1,758,215     | \$ 2,011,078      |
| Total revenues                                  | 1,647,624        | 1,878,269         | 1,797,687        | 2,051,721         |
| Gross earnings (a)                              | 150,024          | 185,510           | 178,607          | 243,665           |
| Net income                                      | 16,118           | 27,999            | 23,239           | 47,045            |
| Per common share, diluted                       | 0.23             | 0.40              | 0.33             | 0.67              |

(a) Gross earnings equals total revenues less cost of sales, including buying and occupancy costs.

(b) In the fiscal year ended January 28, 2006, net income included gains from House2Home bankruptcy recoveries of \$2.9 million, or \$.04 per diluted share, in the first quarter and \$0.1 million in the third quarter; net income also included a gain of \$0.1 million from the reduction of contingent lease obligations in the fourth quarter.

Also in the fiscal year ended January 28, 2006, net income included a first quarter loss of \$1.8 million, or \$.03 per diluted share, and a fourth quarter loss of \$0.6 million, or \$.01 per diluted share, to increase the Company's reserve for claims for various credit card issuing banks. In the third quarter of the fiscal year ended January 28, 2006, net income included a gain of \$1.9 million, or \$.03 per diluted share, in connection with a settlement reached in the VISA/MasterCard settlement class action litigation.

(c) In the fiscal year ended January 29, 2005, net income included gains from the reduction of contingent lease obligations (including House2Home bankruptcy recoveries) of \$3.1 million, or \$.04 per diluted share, in each of the second quarter and third quarter.

Also in the fiscal year ended January 29, 2005, net income included a second quarter loss of \$3.6 million, or \$.05 per diluted share, and a third quarter loss of \$0.6 million, or \$.01 per diluted share, to establish a reserve for claims by various credit card issuing banks. In the third quarter, net income also included a loss of \$1.7 million, or \$.02 per diluted share, in discontinued operations to increase the reserve for closed clubs. In the fourth quarter, net income included a loss of \$4.3 million, or \$.06 per diluted share, as a result of a correction of errors in accounting for certain of the Company's leases. On a pretax basis, this loss was \$7.2 million. See Note E for additional information.

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

**To the Board of Directors and Stockholders of BJ's Wholesale Club, Inc.:**

We have completed integrated audits of BJ's Wholesale Club, Inc.'s 2006 and 2005 consolidated financial statements and of its internal control over financial reporting as of January 28, 2006 and an audit of its 2004 consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

*Consolidated financial statements*

In our opinion, the consolidated financial statements listed in the accompanying index, present fairly, in all material respects, the financial position of BJ's Wholesale Club, Inc. and its subsidiaries at January 28, 2006 and January 29, 2005, and the results of their operations and their cash flows for each of the three years in the period ended January 28, 2006 in conformity with accounting principles generally accepted in the United States of America. 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 of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). 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 of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note A to the financial statements, the Company adopted the provisions of Statement of Financial Accounting Standards No. 143, Accounting for Asset Retirement Obligations, on February 2, 2003.

*Internal control over financial reporting*

Also, in our opinion, management's assessment, included in Management's Report on Internal Control over Financial Reporting appearing under Item 8, that the Company maintained effective internal control over financial reporting as of January 28, 2006 based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of January 28, 2006, based on criteria established in *Internal Control - Integrated Framework* issued by the COSO. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

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A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail,

accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/S/PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

Boston, Massachusetts

April 12, 2006

#### **MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

The management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) promulgated under the Securities Exchange Act of 1934).

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

BJ's management assessed the effectiveness of the Company's internal control over financial reporting as of January 28, 2006. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control-Integrated Framework*. Based on its assessment, management concluded that, as of January 28, 2006, the Company's internal control over financial reporting was effective based on those criteria.

PricewaterhouseCoopers LLP, an independent registered public accounting firm, has audited the Company's assessment of the effectiveness of its internal controls over financial reporting as of January 28, 2006 as stated in their report, which appears herein.

April 12, 2006





**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

Not applicable.

**Item 9A. Controls and Procedures**

The Company's management, with the participation of the Company's chief executive officer and chief financial officer, evaluated the effectiveness of the Company's disclosure controls and procedures as of January 28, 2006. The term "disclosure controls and procedures," as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the Company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of the Company's disclosure controls and procedures as of January 28, 2006, the Company's chief executive officer and chief financial officer concluded that, as of such date, the Company's disclosure controls and procedures were effective at the reasonable assurance level.

Management's report on the Company's internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) and the independent registered public accounting firm's related audit report are included in Item 8 of this Form 10-K and are incorporated herein by reference.

No change in the Company's internal control over financial reporting occurred during the fiscal quarter ended January 28, 2006 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

**Item 9B. Other Information**

Not applicable.

**PART III**

**Item 10. Directors and Executive Officers of the Registrant**

The Company will file with the Securities and Exchange Commission ( SEC ) a definitive Proxy Statement no later than 120 days after the close of its fiscal year ended January 28, 2006 (the Proxy Statement ). The information required by this Item and not given in Item 4A, Executive Officers of the Registrant, is incorporated by reference from the Proxy Statement under Election of Directors, Section 16(a) Beneficial Ownership Reporting Compliance, Policies on Business Ethics and Conduct and Audit Committee.

*Website Availability of Corporate and Other Documents*

The following documents are available on the Corporate Governance section of the Company's website, [www.bjs.com](http://www.bjs.com): corporate governance principles; charters of the Audit, Corporate Governance and Executive Compensation Committees; and the Statement on Commercial Bribery, Conflicts of Interest and Business Ethics. Stockholders can also request a copy of any of these documents by writing to the Corporate Secretary, BJS Wholesale Club, Inc., One Mercer Road, Natick, MA 01760. The Company intends to post on its website all disclosures that are required by law or NYSE listing standards concerning any amendments to, or waivers from, any provision of the Statement on Commercial Bribery, Conflicts of Interest and Business Ethics.

**Item 11. Executive Compensation**

The information required by this Item is incorporated by reference from the Proxy Statement under Executive Compensation. However, information under Executive Compensation Committee Report on Executive Compensation in the Proxy Statement is not so incorporated.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

The information required by this Item is incorporated by reference from the Proxy Statement under Beneficial Ownership of Common Stock and Equity Compensation Plan Information.

**Item 13. Certain Relationships and Related Transactions**

The information required by this Item is incorporated by reference from the Proxy Statement under Certain Transactions and Relationship with House2Home; Conflicts of Interest.

**Item 14. Principal Accounting Fees and Services**

The information required by this Item is incorporated by reference from the Proxy Statement under Independent Auditors Fees and Other Matters.



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**PART IV**
**Item 15. Exhibits and Financial Statement Schedules**

A. The Financial Statements filed as part of this report are listed and indexed on page 26. Schedules have been omitted because they are not applicable or the required information has been included elsewhere in this report.

B. Listed below are all Exhibits filed as part of this report.

**Exhibit**

| <u>No.</u> | <u>Exhibit</u>  |
|------------|---|
| 3.1        | Amended and Restated Certificate of Incorporation (1)   |
| 3.2        | Amended and Restated By-Laws (5)  |
| 4.1        | Amended and Restated Rights Agreement, dated as of November 17, 2003, between the Company and The Bank of New York (13)               |
| 4.2        | Specimen Certificate of Common Stock, \$.01 par value per share (4)   |
| 10.1       | Separation and Distribution Agreement, dated as of July 10, 1997 between the Company and Waban Inc. (2)                               |
| 10.2       | Services Agreement, dated as of July 28, 1997, between the Company and Waban Inc. (2)   |
| 10.3       | Tax Sharing Agreement, dated as of July 28, 1997, between the Company and Waban Inc. (2)  |
| 10.4       | Employee Benefits Agreement, dated as of July 28, 1997, between the Company and Waban Inc. (2)  |
| 10.5       | 2003 Amendment and Restatement of Management Incentive Plan* (11)   |
| 10.5a      | Criteria for 2005 Awards under Management Incentive Plan* (17)  |
| 10.6       | 2003 Amendment and Restatement of Growth Incentive Plan* (12)   |
| 10.6a      | Criteria for 2005-2007 Awards under Growth Incentive Plan* (17)   |
| 10.7       | BJ s Wholesale Club, Inc. Executive Retirement Plan, as amended* (7)  |
| 10.8       | BJ s Wholesale Club, Inc. 1997 Replacement Stock Incentive Plan* (3)  |
| 10.9       | BJ s Wholesale Club, Inc. 1997 Stock Incentive Plan, as amended through May 20, 2004* (15)  |
| 10.10      | BJ s Wholesale Club, Inc. General Deferred Compensation Plan* (3)   |
| 10.11      | Employment Agreement, dated as of July 28, 1997 with Herbert J. Zarkin* (3)   |
| 10.11a     | Amendment effective September 14, 2000 to July 28, 1997 Employment Agreement with Herbert J. Zarkin*(8)                               |
| 10.11b     | Second Amendment effective as of August 9, 2004 to July 28, 1997 Employment Agreement with Herbert J. Zarkin* (16)                    |
| 10.11c     | Nonstatutory Stock Option Agreement Granted under 1997 Stock Incentive Plan to Herbert J. Zarkin on August 9, 2004* (16)              |
| 10.11d     | Restricted Stock Award under 1997 Stock Incentive Plan to Herbert J. Zarkin, effective August 9, 2004* (16)                           |
| 10.12      | Employment Agreement, dated as of July 28, 1997 with Frank D. Forward* (3)  |
| 10.13      | Amendment dated as of February 4, 2004 to February 4, 1999 Change of Control Agreement between the Company and Frank D. Forward* (14) |
| 10.14      | Employment Agreement, dated as of July 28, 1997 with Michael T. Wedge* (3)  |
| 10.14a     | Amendment dated as of September 9, 2002 to February 4, 1999 Change of Control Agreement between the Company and Michael T. Wedge* (9) |

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| No.    | Exhibit  |
|--------|--|
| 10.15  | Employment Agreement, dated as of December 1, 2000 with Edward F. Giles* (10)  |
| 10.16  | Amendment dated as of February 4, 2004 to September 9, 2002 Change of Control Agreement between the Company and Edward F. Giles* (14)  |
| 10.17  | Employment Agreement, dated as of February 6, 2003 with Kellye L. Walker* (14)   |
| 10.18  | Employment Agreement, dated as of July 6, 2004 with Karen Stout* (18)  |
| 10.19  | Change of Control Agreement, dated as of July 6, 2004 between the Company and Karen Stout* (18)  |
| 10.20  | Employment Agreement, dated as of August 31, 2004 with Alison Gregg Corcoran*  |
| 10.20a | Change of Control Severance Agreement, dated as of September 21, 2005 with Alison Gregg Corcoran*  |
| 10.20b | First Amendment to Employment Agreement dated as of October 1, 2005 with Alison Gregg Corcoran*  |
| 10.21  | Amended and Restated Form of Change of Control Severance Agreement between the Company and officers of the Company* (6)  |
| 10.22  | Form of Indemnification Agreement between the Company and officers of the Company* (3)   |
| 10.23  | BJ s Wholesale Club, Inc. Change of Control Severance Benefit Plan for Key Employees, as amended* (7)  |
| 10.23a | Amendment dated as of February 4, 2004 to BJ s Wholesale Club, Inc. Change of Control Severance Benefit Plan for Key Employees, as amended* (14)   |
| 10.24  | Form of Nonstatutory Stock Option Agreement Granted under 1997 Stock Incentive Plan* (16)  |
| 10.25  | Form of Restricted Stock Agreement under 1997 Stock Incentive Plan* (16)   |
| 10.26  | Credit Agreement, dated April 28, 2005, among the Company and certain banks (19)   |
| 10.27  | Indemnification Agreement, dated as of April 18, 1997, between the Company and The TJX Companies, Inc. (4)   |
| 10.28  | Summary of Company s Non-Employee Director Compensation*   |
| 10.29  | Base Salaries of Executive Officers of the Company*  |
| 21.0   | Subsidiaries of the Company  |
| 23.0   | Consent of Independent Accountants   |
| 31.1   | Chief Executive Officer-Certification pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                            |
| 31.2   | Chief Financial Officer-Certification pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                            |
| 32.1   | Chief Executive Officer-Certification pursuant to Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 32.2   | Chief Financial Officer-Certification pursuant to Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |

\* Management contract or other compensatory plan or arrangement.

- (1) Incorporated herein by reference to the Company s Registration Statement on Form S-8, (Commission File No. 333-31015)
- (2) Incorporated herein by reference to the Current Report on Form 8-K, dated July 28, 1997, of HomeBase, Inc. (Commission File No. 001-10259)
- (3) Incorporated herein by reference to the Company s Quarterly Report on Form 10-Q for the fiscal quarter ended July 26, 1997 (Commission File No. 001-13143)

- (4) Incorporated herein by reference to the Company's Registration Statement on Form S-1 (Commission File No. 333-25511)
- (5) Incorporated herein by reference to the Company's Current Report on Form 8-K, dated as of April 7, 1999 (Commission File No. 001-13143)
- (6) Incorporated herein by reference to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended October 30, 1999 (Commission File No. 001-13143)
- (7) Incorporated herein by reference to the Company's Annual Report on Form 10-K for the fiscal year ended January 29, 2000 (Commission File No. 001-13143)
- (8) Incorporated herein by reference to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended October 28, 2000 (Commission File No. 001-13143)
- (9) Incorporated herein by reference to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended November 2, 2002 (Commission File No. 001-13143)
- (10) Incorporated herein by reference to the Company's Annual Report on Form 10-K for the fiscal year ended February 1, 2003 (Commission File No. 001-13143)
- (11) Incorporated herein by reference to Appendix D of the Company's Definitive Proxy Statement as filed on April 22, 2003 (Commission File No. 001-13143)
- (12) Incorporated herein by reference to Appendix E of the Company's Definitive Proxy Statement as filed on April 22, 2003 (Commission File No. 001-13143)
- (13) Incorporated herein by reference to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended November 1, 2003 (Commission File No. 001-13143)
- (14) Incorporated herein by reference to the Company's Annual Report on Form 10-K for the fiscal year ended January 31, 2004 (Commission File No. 001-13143)
- (15) Incorporated herein by reference to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended May 1, 2004 (Commission File No. 001-13143)
- (16) Incorporated herein by reference to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended July 31, 2004 (Commission File No. 001-13143)
- (17) Incorporated herein by reference to the Company's Current Report on Form 8-K dated as of February 2, 2005 (Commission File No. 001-13143)
- (18) Incorporated herein by reference to the Company's Annual Report on Form 10-K for the fiscal year ended January 29, 2005 (Commission File No. 001-13143)
- (19) Incorporated herein by reference to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended April 30, 2005 (Commission File No. 001-13143)

**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.

Dated: April 12, 2006

BJ S WHOLESALE CLUB, INC.

/s/ MICHAEL T. WEDGE  
**Michael T. Wedge**  
*President and Chief*

*Executive Officer*

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 date indicated.

/s/ MICHAEL T. WEDGE  
**Michael T. Wedge,**  
*Chief Executive Officer and Director*

*(Principal Executive Officer)*

/s/ FRANK D. FORWARD  
**Frank D. Forward,**  
*Executive Vice President and*

*Chief Financial Officer*

*(Principal Financial and Accounting Officer)*

/s/ PAUL DANOS  
**Paul Danos,**  
*Director*

/s/ BERT N. MITCHELL  
**Bert N. Mitchell,**  
*Director*

/s/ THOMAS J. SHIELDS  
**Thomas J. Shields,**  
*Director*

/s/ HERBERT J. ZARKIN  
**Herbert J. Zarkin,**  
*Chairman of the Board and Director*

/s/ S. JAMES COPPERSMITH  
**S. James Coppersmith,**  
*Director*

/s/ RONALD R. DION  
**Ronald R. Dion,**  
*Director*

/s/ HELEN FRAME PETERS  
**Helen Frame Peters,**  
*Director*

/s/ LORNE R. WAXLAX  
**Lorne R. Waxlax,**  
*Director*

Dated: April 12, 2006