OFFICE DEPOT INC
Form 10-Q
July 26, 2007

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
FORM 10-Q

(Mark One)
x Quarterly Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934

For the quarterly period ended June 30, 2007

or

o Transition Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934

For the transition period from _____ to _____

Commission file number 1-10948
Office Depot, Inc.
(Exact name of registrant as specified in its charter)

Delaware	**59-2663954**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
2200 Old Germantown Road; Delray Beach, Florida	**33445**
(Address of principal executive offices)	(Zip Code)

(561) 438-4800
(Registrant s telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

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 x Accelerated filer o Non-accelerated filer o

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

The number of shares outstanding of the registrant s common stock, as of the latest practicable date: At June 30, 2007 there were 272,769,744 outstanding shares of Office Depot, Inc. Common Stock, $0.01 par value.

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

OFFICE DEPOT, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share amounts)
(Unaudited)

	As of June 30, 2007	As of December 30, 2006	As of July 1, 2006
Assets			
Current assets:			
Cash and cash equivalents	$ 122,695	$ 173,552	$ 341,350
Receivables, net	1,466,714	1,480,316	1,314,333
Inventories, net	1,615,598	1,559,981	1,450,440
Deferred income taxes	53,348	124,345	121,750
Prepaid expenses and other current assets	148,295	116,931	116,749
Total current assets	3,406,650	3,455,125	3,344,622
Property and equipment, net	1,463,361	1,424,967	1,326,128
Goodwill	1,228,681	1,198,886	1,091,427
Other assets	548,275	491,124	445,508
Total assets	$ 6,646,967	$ 6,570,102	$ 6,207,685
Liabilities and stockholders equity			
Current liabilities:			
Trade accounts payable	$ 1,582,487	$ 1,561,784	$ 1,477,506
Accrued expenses and other current liabilities	1,095,197	1,224,565	1,068,020
Income taxes payable	2,167	135,448	117,774
Short-term borrowings and current maturities of long-term debt	68,878	48,130	34,114
Total current liabilities	2,748,729	2,969,927	2,697,414
Deferred income taxes and other long-term liabilities	534,679	403,289	368,170
Long-term debt, net of current maturities	564,107	570,752	581,761
Minority interest	14,737	16,023	10,270
Commitments and contingencies			
Stockholders equity:			
Common stock authorized 800,000,000 shares of $.01 par value; issued and outstanding shares 428,553,951 in 2007, 426,177,619 in December 2006 and 425,075,847 in July 2006	4,286	4,262	4,251

Additional paid-in capital	1,757,070	1,700,976	1,652,554
Accumulated other comprehensive income	340,551	295,253	249,752
Retained earnings	3,665,774	3,383,202	3,114,903
Treasury stock, at cost 155,784,207 shares in 2007, 149,778,235 shares in December 2006 and 141,798,878 shares in July 2006	(2,982,966)	(2,773,582)	(2,471,390)
Total stockholders equity	2,784,715	2,610,111	2,550,070
Total liabilities and stockholders equity	$ 6,646,967	$ 6,570,102	$ 6,207,685

This report should be read in conjunction with the Notes to Condensed Consolidated Financial Statements (Notes) herein and the Notes to Consolidated Financial Statements in the Office Depot, Inc. Form 10-K filed February 14, 2007 (the 2006 Form 10-K).

OFFICE DEPOT, INC.
CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS
(In thousands, except per share amounts)
(Unaudited)

	13 Weeks Ended		26 Weeks Ended	
	June 30, 2007	July 1, 2006	June 30, 2007	July 1, 2006
Sales	$ 3,631,599	$ 3,494,907	$ 7,725,199	$ 7,310,607
Cost of goods sold and occupancy costs	2,529,793	2,416,665	5,350,911	5,030,459
Gross profit	1,101,806	1,078,242	2,374,288	2,280,148
Store and warehouse operating and selling expenses	799,494	756,505	1,685,186	1,600,026
General and administrative expenses	149,788	150,324	311,318	316,877
Amortization of deferred gain on building sale	(1,873)		(3,746)	
Operating profit	154,397	171,413	381,530	363,245
Other income (expense):				
Interest income	1,241	1,086	2,101	7,345
Interest expense	(18,031)	(11,347)	(30,671)	(22,413)
Miscellaneous income, net	9,874	6,625	19,695	14,089
Earnings before income taxes	147,481	167,777	372,655	362,266
Income taxes	38,405	49,471	107,735	114,430
Net earnings	$ 109,076	$ 118,306	$ 264,920	$ 247,836
Earnings per common share:				
Basic	$ 0.40	$ 0.42	$ 0.97	$ 0.87
Diluted	0.40	0.41	0.95	0.85
Weighted average number of common shares outstanding:				
Basic	271,879	280,726	273,690	286,139
Diluted	275,952	287,326	278,041	292,832

This report should be read in conjunction with the Notes herein and the Notes to Consolidated Financial Statements in the 2006 Form 10-K.

OFFICE DEPOT, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	26 Weeks Ended	
	June 30, 2007	**July 1, 2006**
Cash flow from operating activities:		
Net earnings	$ 264,920	$ 247,836
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	139,609	137,373
Charges for losses on inventories and receivables	47,335	42,716
Changes in working capital and other	(158,701)	55,863
Net cash provided by operating activities	293,163	483,788
Cash flows from investing activities:		
Capital expenditures	(225,330)	(121,489)
Acquisitions and related payments	(47,591)	(176,022)
Advance payments	(11,992)	
Proceeds from disposition of assets and advances returned	95,282	21,042
Purchases of short-term investments		(961,450)
Sales of short-term investments		961,650
Net cash used in investing activities	(189,631)	(276,269)
Cash flows from financing activities:		
Proceeds from exercise of stock options and sale of stock under employee stock purchase plans	25,294	82,111
Tax benefits from employee share-based payments	11,625	32,502
Acquisition of treasury stock	(199,592)	(670,222)
Treasury stock purchases related to employee plans	(9,801)	
Net proceeds (payments) on long- and short-term borrowings	16,674	(22,651)
Net cash used in financing activities	(155,800)	(578,260)
Effect of exchange rate changes on cash and cash equivalents	1,411	8,894
Net decrease in cash and cash equivalents	(50,857)	(361,847)
Cash and cash equivalents at beginning of period	173,552	703,197
Cash and cash equivalents at end of period	$ 122,695	$ 341,350

This report should be read in conjunction with the Notes herein and the Notes to Consolidated Financial Statements in the 2006 Form 10-K.

OFFICE DEPOT, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note A Basis of Presentation

Office Depot, Inc., (the Company) including consolidated subsidiaries, is a global supplier of office products and services. Fiscal years are based on a 52- or 53-week period ending on the last Saturday in December. The condensed consolidated balance sheet at December 30, 2006 has been derived from audited financial statements at that date. The condensed interim financial statements as of June 30, 2007 and for the 13-week and 26-week periods ending June 30, 2007 (also referred to as the second quarter of 2007 and the first half of 2007) and July 1, 2006 (also referred to as the second quarter of 2006 and the first half of 2006) are unaudited. However, in our opinion, these financial statements reflect all adjustments (consisting only of normal, recurring items) necessary to provide a fair presentation of our financial position, results of operations and cash flows for the periods presented. In addition to the normal, recurring items recorded for fair interim financial statement presentation, we recognized expenses associated with exit and other activities because the related accounting criteria were met during the period. Certain prior period amounts have been reclassified to conform to current year presentation. We have included the balance sheet from July 1, 2006 to assist in viewing our Company on a full year basis.

These interim results are not necessarily indicative of the results that should be expected for the full year. For a better understanding of Office Depot, Inc. and its financial statements, we recommend reading these condensed interim financial statements in conjunction with the audited financial statements for the year ended December 30, 2006, which are included in our 2006 Annual Report on Form 10-K, filed with the U. S. Securities and Exchange Commission (SEC).

New Accounting Pronouncements

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (FAS 157). This Standard defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. FAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The adoption of FAS 157 is not expected to have a material impact on the Company s financial position, results of operations or cash flows.

The FASB also issued in September 2006 Statement of Financial Accounting Standards No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statement No. 87, 88, 106 and 132(R)* (FAS 158). This Standard includes two phases of implementation. In the first phase adopted in 2006, we reported approximately $6 million of deferred pension losses in accumulated other comprehensive income. The second phase of FAS 158 requires that the valuation date of plan accounts be as of the end of the fiscal year, with that change required to be implemented by fiscal years ending after December 15, 2008. We will change the valuation date relating to our foreign plan, but have not yet analyzed the impact this change will have on our financial condition, results of operations or cash flows.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (FAS 159). This Standard allows companies to elect to follow fair value accounting for certain financial assets and liabilities in an effort to mitigate volatility in earnings without having to apply complex hedge accounting provisions. FAS 159 is applicable only to certain financial instruments and is effective for fiscal years beginning after November 15, 2007. We have not yet completed our assessment of what impact, if any, FAS 159 will have on our financial condition, results of operations or cash flows.

Note B Acquisitions

During the second quarter of 2007, we completed the acquisition of Axidata Inc., a small Canada-based office products delivery company with annual revenue of approximately $60 million. Axidata is included in our North American Business Solutions Division. Both our integration plans and our assessment of the value of assets and liabilities acquired are in the process of being finalized and implemented. Accordingly, the amount initially allocated to goodwill likely will change as the integration and valuation processes are completed and amounts of separately identifiable intangible assets are recorded. The effects of this acquisition are not considered material.

Note C Accounting for Uncertainty in Income Taxes

Effective at the beginning of the first quarter of 2007, we adopted FASB Interpretation No. 48, *Accounting for Uncertainties in Income Taxes* (FIN 48). The impact upon adoption was to increase retained earnings by approximately $17.7 million and to decrease our accruals for uncertain tax positions and related interest by a corresponding amount. Additionally, we increased goodwill and accruals for uncertain tax positions by approximately $3.8 million to reflect the measurement under the rules of FIN 48 of an uncertain tax position related to previous business combinations. After recognizing these impacts at adoption of FIN 48, the total unrecognized tax benefits were approximately $90 million. Of this amount, approximately $69 million would impact our effective tax rate if recognized. The difference of $21 million primarily results from federal tax impacts on state issues and items that would impact goodwill and would not impact the effective rate if it were subsequently determined that such liability were not required. Additionally, adoption of FIN 48 resulted in the accruals for uncertain tax positions being reclassified from Income taxes payable to Accrued expenses and other long-term liabilities in our Condensed Consolidated Balance Sheet.

We regularly evaluate the legal organizational structure of our entities, tax regulatory developments and the progress of ongoing tax examinations and adjust tax attributes to enhance planning opportunities. While we are evaluating certain transactions that could reduce the need for certain accruals during fiscal year 2007, those considerations are not yet sufficiently developed to allow further adjustment to existing balances. One such transaction is a corporate restructuring that relates to one of the projects covered by our Charges (see Note G). Should that restructuring change our assessment of the need for an existing accrual for uncertain tax positions of approximately $10 million, that reduction in our tax provision would be presented as a tax-related benefit to the Charges when recognized.

We file income tax returns in the U.S. federal jurisdiction and various states and foreign jurisdictions. With few exceptions, we are no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations for years before 2000. Our U.S. federal filings for the years 2000 and 2002 through 2006 are under routine examination and that process is anticipated to be completed before the end of 2008. Additionally, the U.S. federal tax return for 2007 is under concurrent year processing and the review should be complete in early 2008. Also, significant international tax jurisdictions include the United Kingdom, the Netherlands, France and Germany. Generally, we are subject to routine examination for years 2000 and forward in these jurisdictions.

We recognize interest related to unrecognized tax benefits in interest expense and penalties in the provision for income taxes. During 2006, we recognized approximately $5 million in interest and penalties. The Company had approximately $29 million accrued for the payment of interest and penalties as of the date of adoption of FIN 48.

Note D Comprehensive Income

Comprehensive income represents all non-owner changes in stockholders equity and consists of the following:

(In thousands)	Second Quarter		First Half	
	2007	**2006**	**2007**	**2006**
Net earnings	$ 109,076	$ 118,306	$ 264,920	$ 247,836
Other comprehensive income:				
Foreign currency translation adjustments, net	31,215	83,297	45,101	108,806
Amortization of gain on cash flow hedge	(414)	(415)	(829)	(829)
Unrealized gain (loss) on cash flow hedge	(19)	823	1,026	1,030
Total comprehensive income	$ 139,858	$ 202,011	$ 310,218	$ 356,843

Note E Earnings Per Share (EPS)

The information related to our basic and diluted EPS is as follows:

(In thousands, except per share amounts)	Second Quarter		First Half	
	2007	**2006**	**2007**	**2006**
Numerator:				
Net earnings	$ 109,076	$ 118,306	$ 264,920	$ 247,836
Denominator:				
Weighted average shares outstanding:				
Basic	271,879	280,726	273,690	286,139
Effect of dilutive stock options and restricted stock	4,073	6,600	4,351	6,693
Diluted	275,952	287,326	278,041	292,832
EPS:				
Basic	$ 0.40	$ 0.42	$ 0.97	$ 0.87
Diluted	0.40	0.41	0.95	0.85

Note F Division Information

We continually assess our financial reporting practices and strive to provide meaningful and transparent communication of our results. In the third quarter of 2006, we modified our measurement of Division operating profit for segment reporting purposes to exclude the impact of costs related to asset impairments, exit costs and other charges, which resulted from a wide-ranging assessment of assets and commitments which began during the latter half of 2005 (the Charges see Note G). The financial information used by our management to assess performance of the Divisions for the purpose of resource allocation now excludes the Charges. We believe this measure is an appropriate and useful indicator of the effectiveness of current management activities. Prior period Division operating profit has been recast to conform to the current presentation.

The following is a summary of our significant accounts and balances by reportable segment (or Division), reconciled to consolidated totals.

(In thousands)	Sales			
	Second Quarter		First Half	
	2007	2006	2007	2006
North American Retail Division	$ 1,525,334	$ 1,507,612	$ 3,373,934	$ 3,298,340
North American Business Solutions Division	1,123,242	1,128,676	2,285,592	2,258,673
International Division	983,023	858,619	2,065,673	1,753,594
Total	$ 3,631,599	$ 3,494,907	$ 7,725,199	$ 7,310,607

(In thousands)	Division Operating Profit			
	Second Quarter		First Half	
	2007	2006	2007	2006
North American Retail Division	$ 103,596	$ 96,386	$ 258,284	$ 231,211
North American Business Solutions Division	79,659	104,928	152,909	198,569
International Division	42,134	48,468	124,197	117,202
Total reportable segments	225,389	249,782	535,390	546,982
Eliminations		(27)	(73)	(155)
Total	$ 225,389	$ 249,755	$ 535,317	$ 546,827

A reconciliation of the measure of Division operating profit to consolidated earnings before income taxes is as follows:

(In thousands)	Second Quarter		First Half	
	2007	2006	2007	2006
Total division operating profit	$ 225,389	$ 249,755	$ 535,317	$ 546,827
Charges, as defined above	(11,883)	(8,129)	(23,947)	(26,886)
Corporate general and administrative expenses (excluding Charges)	(60,982)	(70,213)	(133,586)	(156,696)
Amortization of deferred gain	1,873		3,746	
Interest income	1,241	1,086	2,101	7,345
Interest expense	(18,031)	(11,347)	(30,671)	(22,413)
Miscellaneous income, net	9,874	6,625	19,695	14,089
Earnings before income taxes	$ 147,481	$ 167,777	$ 372,655	$ 362,266

Goodwill by division is as follows:

(In thousands)	Goodwill		
	June 30, 2007	December 30, 2006	July 1, 2006
North American Retail Division	$ 2,147	$ 1,961	$ 2,046
North American Business Solutions Division	366,993	359,417	335,040

International Division	859,541	837,508	754,341
Total	$ 1,228,681	$ 1,198,886	$ 1,091,427

The change in goodwill balances compared to year end and second quarter 2006 result from changes in foreign currency exchange rates on goodwill balances recorded in local functional currencies, a change in a tax valuation allowance related to an earlier acquisition, the acquisitions during the periods, the resolution of fair value estimates on certain acquisitions made in 2006, and impacts from the adoption of FIN 48 relating to tax uncertainties associated with an earlier period acquisition.

Note G Asset Impairments, Exit Costs and Other Charges

During the third quarter of 2005, we announced a number of material charges relating to asset impairments, exit costs and other operating decisions (the Charges). This announcement followed a wide-ranging assessment of assets and commitments which began in the second quarter of 2005. From inception through the end of the second quarter of 2007, we had recorded $369 million of Charges. Expenses associated with future activities will be recognized as the individual plans are implemented and the related accounting recognition criteria are met. As with any estimate, the amounts may change when expenses are incurred.

During the second quarter of 2007, we recognized approximately $12 million of Charges associated with these projects as the previously-identified plans were implemented and the related accounting recognition criteria were met. Approximately $10 million is included in store and warehouse operating and selling expenses and $2 million is included in general and administrative expenses. Implementation of projects during the quarter resulted in Charges for severance-related expenses and accelerated depreciation. The 2007 year-to-date Charges totaled $24 million, of which, approximately $19 million is presented in store and warehouse operating and selling expense and $5 million is presented in general and administrative expenses.

The following table summarizes the Charges recognized in the first half of 2007 by type of activity as well as changes in the related accrual balances.

(In millions)	Beginning Balance at January 1, 2007	Charge incurred	Cash payments	Non-cash settlements	Currency and Other Adjustments	Ending Balance at June 30, 2007
One-time termination benefits	$ 7	$ 10	$ (7)	$ (1)	$	$ 9
Lease and contract obligations	22		(4)	(1)	(1)	16
Accelerated depreciation		13		(13)		
Other associated costs	2	1		(3)		
Total	$ 31	$ 24	$ (11)	$ (18)	$ (1)	$ 25

Note H Pension Disclosures

The components of net periodic pension cost for our foreign defined benefit plans are as follows:

(In millions)	**Second Quarter**