TOYS R US INC
Form 10-Q
June 14, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q
QUARTERLY REPORT
PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended May 4, 2013
Commission file number 1-11609
TOYS "R" US, INC.
(Exact name of registrant as specified in its charter)

Delaware	22-3260693
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification Number)
One Geoffrey Way Wayne, New Jersey	07470
(Address of principal executive offices)	(Zip code)

(973) 617-3500
(Registrant's telephone number, including area code)

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 ¨

(Note: As a voluntary filer not subject to the filing requirements of Section 13 or 15(d) of the Exchange Act, the registrant has filed all reports pursuant to Section 13 or 15(d) of the Exchange Act during the preceding 12 months as if the registrant were subject to such filing requirements.)

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	x (Do not check if a smaller reporting company)	Smaller reporting company	¨

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

As of June 5, 2013, there were 49,071,989 outstanding shares of common stock of Toys "R" Us, Inc., none of which were publicly traded.

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PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

TOYS "R" US, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

(In millions)	May 4, 2013	February 2, 2013	April 28, 2012
ASSETS			
Current Assets:			
Cash and cash equivalents	$470	$1,118	$609
Accounts and other receivables	275	255	276
Merchandise inventories	2,329	2,229	2,327
Current deferred tax assets	102	104	127
Prepaid expenses and other current assets	169	136	168
Total current assets	3,345	3,842	3,507
Property and equipment, net	3,791	3,891	4,006
Goodwill	443	445	447
Deferred tax assets	246	244	278
Restricted cash	44	16	30
Other assets	454	483	564
Total Assets	$8,323	$8,921	$8,832
LIABILITIES, TEMPORARY EQUITY AND STOCKHOLDERS' EQUITY			
Current Liabilities:			
Accounts payable	$1,273	$1,379	$1,332
Accrued expenses and other current liabilities	761	900	790
Income taxes payable	8	53	32
Current portion of long-term debt	107	339	1,471
Total current liabilities	2,149	2,671	3,625
Long-term debt	5,086	4,990	4,013
Deferred tax liabilities	127	135	152
Deferred rent liabilities	357	356	349
Other non-current liabilities	229	235	236
Temporary equity	67	49	34
Total stockholders' equity	308	485	423
Total Liabilities, Temporary Equity and Stockholders' Equity	$8,323	$8,921	$8,832

See accompanying notes to the Condensed Consolidated Financial Statements.

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TOYS “R” US, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

(In millions)	13 Weeks Ended May 4, 2013	 April 28, 2012
Net sales	$2,408	$2,612
Cost of sales	1,508	1,615
Gross margin	900	997
Selling, general and administrative expenses	886	898
Depreciation and amortization	100	100
Other income, net	(13)	(11)
Total operating expenses	973	987
Operating (loss) earnings	(73)	10
Interest expense	(114)	(112)
Interest income	3	4
Loss before income taxes	(184)	(98)
Income tax benefit	73	38
Net loss	$(111)	$(60)

See accompanying notes to the Condensed Consolidated Financial Statements.

TOYS "R" US, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(Unaudited)

(In millions)	13 Weeks Ended May 4, 2013	 April 28, 2012
Net loss	$(111)	$(60)
Other comprehensive loss, net of tax		
Foreign currency translation adjustments	(46)	(18)
Total other comprehensive loss, net of tax	(46)	(18)
Comprehensive loss, net of tax	$(157)	$(78)

See accompanying notes to the Condensed Consolidated Financial Statements.

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TOYS “R” US, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	13 Weeks Ended	
(In millions)	May 4, 2013	April 28, 2012
Cash Flows from Operating Activities:		
Net loss	$(111)	$(60)
Adjustments to reconcile Net loss to Net cash used in operating activities:		
Depreciation and amortization	100	100
Amortization and write-off of debt issuance costs	10	9
Deferred income taxes	(18)	4
Other	1	4
Changes in operating assets and liabilities:		
Accounts and other receivables	25	30
Merchandise inventories	(125)	(95)
Prepaid expenses and other operating assets	(37)	(37)
Accounts payable, Accrued expenses and other liabilities	(213)	(229)
Income taxes payable and receivable	(93)	(72)
Net cash used in operating activities	(461)	(346)
Cash Flows from Investing Activities:		
Capital expenditures	(53)	(52)
Proceeds from redemption of debt securities	52	—
Purchases of debt securities	(20)	—
Increase in restricted cash	(27)	—
Proceeds from sales of fixed assets	8	6
Acquisitions	—	(5)
Net cash used in investing activities	(40)	(51)
Cash Flows from Financing Activities:		
Long-term debt borrowings	705	412
Long-term debt repayments	(814)	(107)
Short-term debt borrowings, net	(2)	3
Capitalized debt issuance costs	(20)	(2)
Repurchase of common stock	(6)	—
Net cash (used in) provided by financing activities	(137)	306
Effect of exchange rate changes on Cash and cash equivalents	(10)	(1)
Cash and cash equivalents:		
Net decrease during period	(648)	(92)
Cash and cash equivalents at beginning of period	1,118	701
Cash and cash equivalents at end of period	$470	$609

See accompanying notes to the Condensed Consolidated Financial Statements.

TOYS “R” US, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS’ EQUITY
(Unaudited)

	Toys “R” Us, Inc. Stockholders					
	Common Stock (1)					
(In millions)	Issued Shares	Treasury Amount	Additional Paid-in Capital	Total Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders’ Equity
Balance, January 28, 2012	49	$(2)	$35	$426	$ 44	$ 503
Net loss	—	—	—	(60)	—	(60)
Total other comprehensive loss, net of tax	—	—	—	—	(18)	(18)
Stock compensation expense	—	—	3	—	—	3
Adjustment of noncontrolling interest to redemption value	—	—	—	(5)	—	(5)
Balance, April 28, 2012	49	$(2)	$38	$361	$ 26	$ 423
Balance, February 2, 2013	49	$(4)	$47	$445	$ (3)	$ 485
Net loss	—	—	—	(111)	—	(111)
Total other comprehensive loss, net of tax	—	—	—	—	(46)	(46)
Repurchase of common stock	—	(14)	—	—	—	(14)
Issuance of common stock	—	9	(2)	—	—	7
Stock compensation expense	—	—	5	—	—	5
Redemption value of redeemable shares to temporary equity	—	—	(12)	—	—	(12)
Adjustment of noncontrolling interest to redemption value	—	—	—	(6)	—	(6)
Balance, May 4, 2013	49	$(9)	$38	$328	$ (49)	$ 308

(1) For all periods presented, the par value amount of Common Stock issued is less than $1 million. The number of Common Stock shares in treasury is also less than 1 million.
See accompanying notes to the Condensed Consolidated Financial Statements.

TOYS “R” US, INC. AND SUBSIDIARIES
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of presentation

As used herein, the “Company,” “we,” “us,” or “our” means Toys “R” Us, Inc., and its consolidated subsidiaries, except as expressly indicated or unless the context otherwise requires. The Condensed Consolidated Balance Sheets as of May 4, 2013, February 2, 2013 and April 28, 2012, the Condensed Consolidated Statements of Operations, the Condensed Consolidated Statements of Comprehensive Loss, the Condensed Consolidated Statements of Cash Flows and the Condensed Consolidated Statements of Stockholders’ Equity for the thirteen weeks ended May 4, 2013 and April 28, 2012, have been prepared by us in conformity with accounting principles generally accepted in the United States of America (“GAAP”) for interim reporting, and in accordance with the requirements of this Quarterly Report on Form 10-Q. Our interim Condensed Consolidated Financial Statements are unaudited and are subject to year-end adjustments. In the opinion of management, the financial statements include all known adjustments (which consist primarily of normal, recurring accruals, estimates and assumptions that impact the financial statements) necessary to present fairly the financial position at the balance sheet dates and the results of operations for the thirteen weeks then ended. The Condensed Consolidated Balance Sheet at February 2, 2013, presented herein, has been derived from our audited balance sheet included in our Annual Report on Form 10-K for the fiscal year ended February 2, 2013, but does not include all disclosures required by GAAP. These financial statements should be read in conjunction with the consolidated financial statements and footnotes thereto included within our Annual Report on Form 10-K for the fiscal year ended February 2, 2013. The results of operations for the thirteen weeks ended May 4, 2013 and April 28, 2012 are not necessarily indicative of operating results for the full year.

Variable Interest Entities

On March 25, 2013, our indirect wholly-owned subsidiary, Toys “R” Us Properties (UK) Limited (“UK Propco”) entered into a facility agreement (the “New UK Propco Facility Agreement”) with Debussy DTC Plc (“Debussy”), pursuant to which Debussy made loans (collectively, the “New UK Propco Loan”) to UK Propco on March 28, 2013 in the aggregate principal amount of £263 million ($410 million at May 4, 2013). Debussy is a special purpose entity established with the limited purpose of making loans and issuing the £263 million of multiple classes of commercial mortgage backed fixed rate notes (the “Debussy Notes”) to third party investors and the Company. Refer to Note 2 entitled “Short-term borrowings and long-term debt” for further details.

In accordance with Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) Topic 810, “Consolidation”, we identified Debussy as a variable interest entity because Debussy, by design, has insufficient equity investment at risk and its equity investment holders at risk lack the ability, through voting or similar rights, to direct the activities that most significantly impact Debussy’s economic performance. Additionally, we evaluated our variable interests in Debussy and third party investors’ involvement in Debussy and concluded that the Company is not the primary beneficiary and therefore should not consolidate Debussy as we do not hold the power to direct the activities that most significantly impact Debussy’s economic performance.

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2. Short-term borrowings and long-term debt

A summary of the Company's consolidated Short-term borrowings and Long-term debt as of May 4, 2013, February 2, 2013 and April 28, 2012 is outlined in the table below:

(In millions)	May 4, 2013	February 2, 2013	April 28, 2012
Short-term borrowings			
Labuan uncommitted lines of credit	$12	$14	$12
Long-term debt			
Spanish real estate credit facility, due fiscal 2012	—	—	168
French real estate credit facility, due fiscal 2013 (1)	—	83	81
UK real estate senior credit facility, due fiscal 2013 (2)	—	543	565
UK real estate junior credit facility, due fiscal 2013 (2)	—	94	98
7.875% senior notes, due fiscal 2013 (3)	—	—	398
Toys-Japan unsecured credit lines, expire fiscals 2013-2014	75	27	101
Secured revolving credit facility, expires fiscal 2015 (4)	61	—	—
Spanish real estate credit facility, due fiscal 2015	96	102	—
European and Australian asset-based revolving credit facility, expires fiscal 2016	—	—	—
Secured term loan facility, due fiscal 2016 (4)	676	677	681
7.375% senior secured notes, due fiscal 2016 (4)	361	361	363
10.750% senior notes, due fiscal 2017 (5)	934	934	932
10.375% senior notes, due fiscal 2017 (3)	446	446	—
8.500% senior secured notes, due fiscal 2017 (6)	718	718	717
French real estate credit facility, due fiscal 2018 (1)	63	—	—
Incremental secured term loan facility, due fiscal 2018 (4)	390	391	393
Second incremental secured term loan facility, due fiscal 2018 (4)	219	220	220
7.375% senior notes, due fiscal 2018 (3)	403	404	404
UK real estate credit facility, due fiscal 2020 (2)	410	—	—
Toys-Japan 1.85%-2.85% loans, due fiscals 2013-2021 (7)	115	107	151
8.750% debentures, due fiscal 2021 (8)	22	22	22
Finance obligations associated with capital projects	172	163	151
Capital lease obligations	32	37	39
	5,193	5,329	5,484
Less current portion	107	339	1,471
Total Long-term debt (9)	$5,086	$4,990	$4,013

(1) On February 27, 2013, Toys "R" Us France Real Estate SAS ("TRU France Real Estate") entered into a five year senior secured term loan facility agreement (the "France Propco Facility Agreement") for an aggregate principal amount of €48 million ($63 million at May 4, 2013). The net proceeds of the loan under the France Propco Facility Agreement, together with cash on hand, were used to repay the principal balance of the €61 million French real estate credit facility due fiscal 2013.

(2) On March 25, 2013, UK Propco entered into the New UK Propco Facility Agreement, which was funded on March 28, 2013, for an aggregate principal amount of £263 million ($410 million at May 4, 2013). The net proceeds of the loan under the New UK Propco Facility Agreement, together with cash on hand, were used to repay the principal balance of the UK real estate senior and junior credit facilities.

(3) Represents obligations of Toys "R" Us, Inc. (the "Parent Company").

(4) Represents obligations of Toys "R" Us-Delaware, Inc. ("Toys-Delaware").

(5) Represents obligations of Toys "R" Us Property Company I, LLC and its subsidiaries ("TRU Propco I").

(6) Represents obligations of Toys "R" Us Property Company II, LLC ("TRU Propco II").

(7) On February 28, 2013, Toys "R" Us - Japan, Ltd. ("Toys-Japan") entered into an additional bank loan with a financial institution for ¥2.0 billion ($20 million at May 4, 2013).

(8) Represents obligations of the Parent Company and Toys-Delaware.

(9) We maintain derivative instruments on certain of our long-term debt, which impact our effective interest rates. Refer to Note 3 entitled "Derivative instruments and hedging activities" for further details.

Toys "R" Us, Inc. is a holding company and conducts its operations through its subsidiaries, certain of which have incurred their own indebtedness. Our credit facilities, loan agreements and indentures contain customary covenants, including, among other things, covenants that restrict our ability to:

- incur certain additional indebtedness;
- transfer money between the Parent Company and our various subsidiaries;
- pay dividends on, repurchase or make distributions with respect to our or our subsidiaries' capital stock or make other restricted payments;
- issue stock of subsidiaries;
- make certain investments, loans or advances;
- transfer and sell certain assets;
- create or permit liens on assets;
- consolidate, merge, sell or otherwise dispose of all or substantially all of our assets;
- enter into certain transactions with our affiliates; and
- amend certain documents.

The amount of net assets that were subject to such restrictions was approximately $975 million as of May 4, 2013.

Our agreements also contain various and customary events of default with respect to the indebtedness, including, without limitation, the failure to pay interest or principal when the same is due under the agreements, cross default and cross acceleration provisions, the failure of representations and warranties contained in the agreements to be true and certain insolvency events. If an event of default occurs and is continuing, the principal amounts outstanding thereunder, together with all accrued and unpaid interest and other amounts owed thereunder, may be declared immediately due and payable by the lenders.

We are dependent on the borrowings provided by the lenders to support our working capital needs, capital expenditures and to service debt. As of May 4, 2013, we have funds available to finance our operations under our European and Australian asset-based revolving credit facility ("European ABL Facility") through March 2016, our Secured revolving credit facility ("ABL Facility") through August 2015 and our Toys-Japan unsecured credit lines with a tranche maturing June 2013 and a tranche maturing June 2014. In addition, Toys (Labuan) Holding Limited ("Labuan") and Toys-Japan have uncommitted lines of credit due on demand.

The total fair values of our Long-term debt, with carrying values of approximately $5.2 billion, $5.3 billion and $5.5 billion at May 4, 2013, February 2, 2013 and April 28, 2012, were $5.4 billion, $5.4 billion and $5.5 billion, respectively. The fair values of our Long-term debt are estimated using the quoted market prices for the same or similar issues and other pertinent information available to management at the end of the respective periods. A portion of these instruments are classified as Level 3, as these are not publicly traded and therefore we are unable to obtain quoted market prices. The fair value of these Level 3 debt instruments totaled approximately $1.0 billion, $1.1 billion and $1.2 billion at May 4, 2013, February 2, 2013 and April 28, 2012, respectively.

Labuan uncommitted lines of credit, due on demand ($12 million at May 4, 2013)

Labuan has several uncommitted unsecured lines of credit with various financial institutions with total availability of HK$332 million ($43 million at May 4, 2013). As of May 4, 2013, we had $12 million of borrowings, which has been included in Accrued expenses and other liabilities on our Condensed Consolidated Balance Sheet, and $3 million of bank guarantees issued under these facilities. The remaining availability under these facilities was $28 million. The average interest rate on the drawn borrowings was 2.43% and 1.99% for the thirteen weeks ended May 4, 2013 and April 28, 2012, respectively.

Toys-Japan unsecured credit lines, expire fiscals 2013 - 2014 ($75 million at May 4, 2013)

Toys-Japan has an agreement with a syndicate of financial institutions, which includes two unsecured loan commitment lines of credit ("Tranche 1" and "Tranche 2"). Tranche 1 is available in amounts of up to ¥12.9 billion ($130 million at May 4, 2013), expiring on June 28, 2013, and bears an interest rate of Tokyo Interbank Offered Rate (“TIBOR”) plus 0.80% per annum. At May 4, 2013, we had outstanding borrowings of $24 million under Tranche 1, with $106 million of remaining availability.

Tranche 2 is available in amounts of up to ¥12.0 billion ($121 million at May 4, 2013), expiring on June 27, 2014, and bears an interest rate of TIBOR plus 0.80% per annum. At May 4, 2013, we had outstanding borrowings of $51 million under Tranche 2, with $70 million of remaining availability.

The agreement contains covenants, including, among other things, covenants that require Toys-Japan to maintain a certain level of net assets and profitability during the agreement terms. The agreement also restricts Toys-Japan from paying dividends or making loans to affiliates without lender consent.

Additionally, Toys-Japan has an uncommitted line of credit with total availability of ¥2.8 billion ($29 million at May 4, 2013), which will renew April 1 of each year unless otherwise canceled. The uncommitted line of credit bears an interest rate of TIBOR plus 0.50%. As of May 4, 2013, we had no outstanding borrowings under the uncommitted line of credit.

$1.85 billion ABL Facility, expires fiscal 2015 ($61 million at May 4, 2013)

At May 4, 2013, under our ABL Facility we had outstanding borrowings of $61 million, a total of $111 million of outstanding letters of credit and excess availability of $949 million. We are also subject to a minimum excess availability covenant, which was $125 million at May 4, 2013, with remaining availability of $824 million in excess of the minimum covenant level.

European ABL Facility, expires fiscal 2016 ($0 million at May 4, 2013)

The European ABL Facility, as amended provides for a five-year £138 million ($215 million at May 4, 2013) asset-based senior secured revolving credit facility which will expire on March 8, 2016. At May 4, 2013, we had no outstanding borrowings, with $145 million of remaining availability under the European ABL Facility.

Toys-Japan bank loans (1.85% to 2.85%), due fiscals 2013-2021 ($115 million at May 4, 2013)

On February 28, 2013, Toys-Japan entered into an additional bank loan with a financial institution for ¥2.0 billion ($20 million at May 4, 2013). The loan will mature on February 26, 2021 and bears an interest rate of 2.18% per annum. Toys-Japan is required to make semi-annual principal payments of ¥125 million ($1 million at May 4, 2013), commencing August 2013.

€48 million French real estate credit facility, due fiscal 2018 ($63 million at May 4, 2013)

On February 27, 2013, TRU France Real Estate entered into the France Propco Facility Agreement for an aggregate principal amount of €48 million ($63 million at May 4, 2013). The net proceeds of the loan under the France Propco Facility Agreement, together with cash on hand, were used to repay the principal balance of the €61 million French real estate credit facility due fiscal 2013. TRU France Real Estate owns freehold and long leasehold interests in properties in various retail markets throughout France. Under an operating company/property company structure, TRU France Real Estate leases these properties on a triple-net basis to Toys "R" Us SARL ("France Opco"). Substantially all of TRU France Real Estate's revenues and cash flows are derived from payments from France Opco under a series of lease agreements. The loan is secured by nine properties located in France. The France Propco Facility Agreement will mature on February 27, 2018 and bears interest equal to EURIBOR plus 4.50%. We have entered into an interest rate cap as required under the France Propco Facility Agreement capping EURIBOR at 2.50% per annum. Additionally, TRU France Real Estate is required to make principal payments equal to 1.25% per year of the original loan amount. As such, approximately $1 million has been classified as Current portion of long-term debt on our Consolidated Balance Sheet. In conjunction with the France Propco Facility Agreement, we incurred transaction fees of approximately $4 million, which have been capitalized as deferred debt issuance costs and will be amortized over the term of the agreement.

The France Propco Facility Agreement contains covenants that, among other things, restrict the ability of TRU France Real Estate to incur additional indebtedness, pay dividends or make other distributions, make restricted payments or certain investments, create or permit liens on assets, sell assets or engage in mergers or consolidations. The agreement also contains financial covenants including a loan to value covenant and an interest coverage ratio covenant relating to France Propco.

£263 million UK real estate credit facility, due fiscal 2020 ($410 million at May 4, 2013)

On March 25, 2013, UK Propco entered into the New UK Propco Facility Agreement with Debussy, pursuant to which Debussy made the New UK Propco Loan to UK Propco on March 28, 2013 in the aggregate principal amount of £263 million ($410 million at May 4, 2013). The net proceeds of the New UK Propco Loan, together with cash on hand, were used to repay the principal balance outstanding under the UK real estate senior and junior credit facilities. UK Propco owns freehold and long leasehold interests in properties in various retail markets throughout the United Kingdom. Under an operating company/property company structure, UK Propco leases these properties on a triple-net basis to Toys “R” Us Limited (“UK Opco”). Substantially all of UK Propco's revenues and cash flows will be derived from payments from UK Opco under a series of amended lease agreements. The New UK Propco Loan is secured by, among other things, 31 owned and leased properties held by UK Propco, certain cash reserve accounts which are classified as Restricted cash on the Condensed Consolidated Balance Sheet and the stock of UK Propco. The New UK Propco Loan bears interest on a weighted average basis of 6.87% per annum plus mandatory costs and matures on July 7, 2020. The New UK Propco Facility Agreement contains covenants that restrict the ability of UK Propco to incur certain additional indebtedness, make restricted payments or certain investments, create or permit liens on assets, dispose of properties, acquire further property, vary or terminate the lease agreements referred to above, conclude further leases or engage in mergers or consolidations. If an event of default, including an event resulting from the failure to comply with a rent to interest coverage ratio applicable to UK Propco, under the New UK Propco Loan occurs and is continuing, the principal amount outstanding, together with all accrued and unpaid interest and other amounts owed may be declared immediately due and payable by the lenders. The loans are subject to mandatory prepayments in certain cases, including from the proceeds of certain permitted property disposals, and UK Propco may optionally prepay the loans at any time, provided that prior to July 7, 2015 and subject to certain exceptions, the loans may only be prepaid in full. Any prepayment prior to July 7, 2015, subject to certain exceptions, shall be subject to a “make whole” premium. Any prepayment occurring during the first, second and third year after July 7, 2015 are subject to a prepayment fee equal to 3%, 2% and 1%, respectively, of the amount of the loan prepaid.

Debussy is a special purpose entity established with the limited purpose of making loans and issuing £263 million ($410 million as of May 4, 2013) of the Debussy Notes to third party investors and the Company. The Company purchased £13 million ($20 million as of May 4, 2013) principal amount of the various classes of the Debussy Notes. These debt securities are included in Other assets within the Condensed Consolidated Balance Sheet, classified as held-to-maturity debt and reported at amortized cost. The proceeds from the Debussy Notes were used to fund the New UK Propco Loan. For further details regarding the consolidation of Debussy, refer to Note 1 entitled “Basis of presentation”. In conjunction with the New UK Propco Loan, we incurred transaction fees of approximately $21 million, which have been capitalized as deferred debt issuance costs and will be amortized over the term of the agreement.

Prior to the refinancing of the UK real estate credit facilities, we designated UK Propco as a “restricted subsidiary” under the indenture for the 10.375% senior notes due fiscal 2017. In addition, in connection with the refinancing, $52 million of the Vanwall Finance PLC notes that we owned were repaid.

Subsequent Event

Secured term loan facility, due fiscal 2016 ($676 million at May 4, 2013)

The Secured term loan facility contains a provision that requires us to repay a specified percentage of excess cash flow generated in the previous fiscal year, as defined in the agreement, starting with the fiscal year ended January 28, 2012. As a result, we borrowed approximately $50 million under our ABL Facility on May 31, 2013 to fund the partial repayment of the Secured Term Loan Facility, including the Incremental and Second Incremental Secured Term Loans on a pro-rata basis. As such, we have continued to classify the $50 million repayment under the secured term loans as long-term on our Condensed Consolidated Balance Sheet.

3. Derivative instruments and hedging activities

We are exposed to market risk from potential changes in interest rates and foreign currency exchange rates. We regularly evaluate our exposure and enter into derivative financial instruments to economically manage these risks. We record all derivatives as either assets or liabilities on the Condensed Consolidated Balance Sheets measured at estimated fair value and we do not offset assets and liabilities with the same counterparty. We recognize the changes in fair value as unrealized gains and losses. The recognition of these gains or losses depends on our intended use of the derivatives and the resulting designation. In certain defined conditions, we may designate a derivative as a hedge for a particular exposure.

Interest Rate Contracts

We and our subsidiaries have a variety of fixed and variable rate debt instruments and are exposed to market risks resulting from interest rate fluctuations. We enter into interest rate swaps and/or caps to reduce our exposure to variability in expected future cash outflows and changes in the fair value of certain Long-term debt, attributable to the changes in LIBOR, EURIBOR, GBP LIBOR and TIBOR rates. Some of our interest rate contracts contain credit-risk related contingent features and are subject to master netting arrangements. As of May 4, 2013, our interest rate contracts have various maturity dates through February 2018. A portion of our interest rate swaps and caps as of May 4, 2013 are designated as cash flow and fair value hedges in accordance with ASC Topic 815, “Derivatives and Hedging.”

The hedge accounting for a designated cash flow hedge requires that the effective portion be recorded to Accumulated other comprehensive (loss) income; the ineffective portion of a cash flow hedge is recorded to Interest expense. We evaluate the effectiveness of our cash flow hedging relationships on an ongoing basis. For our derivatives that are designated as cash flow hedges, no material ineffectiveness was recorded for the thirteen weeks ended May 4, 2013 and April 28, 2012, respectively.

Reclassifications from Accumulated other comprehensive (loss) income to Interest expense primarily relate to realized Interest expense on interest rate swaps and the amortization of gains (losses) recorded on previously terminated or de-designated swaps. We expect to reclassify a net loss of $2 million over the next 12 months to Interest expense from Accumulated other comprehensive (loss) income.

On February 27, 2013, TRU France Real Estate entered into a new interest rate cap to manage its future interest rate exposure in connection with the refinancing of the Company's French real estate credit facility due in fiscal 2013. The interest rate cap has a notional amount of €48 million ($63 million at May 4, 2013) and matures on February 27, 2018. This cap has been designated as a cash flow hedge which institutes a ceiling of 2.50% on the floating-rate EURIBOR exposure associated with our France Propco Facility Agreement.

The hedge accounting for a designated fair value hedge requires that the gain or loss on the derivative as well as the offsetting loss or gain on the hedged item attributable to the hedged risk be recognized in Interest expense. We evaluate the effectiveness of our fair value hedging relationship on an ongoing basis and recalculate the change in the fair value of the derivative and the underlying hedged item separately. For our derivative that is designated as a fair value hedge, we recorded approximately a $1 million net gain in earnings related to ineffectiveness for the thirteen weeks ended May 4, 2013 and April 28, 2012, respectively.

Certain of our agreements with credit-risk related contingent features contain cross-default provisions which provide that we could be declared in default on our derivative obligations if we default on certain specified indebtedness. At February 2, 2013 and April 28, 2012, derivative liabilities related to agreements that contain credit-risk related contingent features had a fair value of $1 million and $7 million, respectively. At May 4, 2013 there were no derivative liabilities related to agreements that contain credit-risk related contingent features. As of May 4, 2013, February 2, 2013 and April 28, 2012, we were not required to post collateral for any of these derivatives.

Foreign Exchange Contracts

We enter into foreign currency forward contracts to economically hedge the USD merchandise purchases of our foreign subsidiaries and our short-term, cross-currency intercompany loans with our foreign subsidiaries. We enter into these contracts in order to reduce our exposure to the variability in expected cash outflows attributable to changes in foreign currency rates. These derivative contracts are not designated as hedges and are recorded on our Condensed Consolidated Balance Sheets at fair value with a gain or loss recorded on the Condensed Consolidated Statements of Operations in Interest expense.

Our foreign exchange contracts typically mature within 12 months. Some of these contracts contain credit-risk related contingent features and are subject to master netting arrangements. Some of these agreements contain provisions which provide that we could be declared in default on our derivative obligations if we default on certain specified indebtedness. At May 4, 2013 and April 28, 2012, derivative liabilities related to agreements that contain credit-risk related contingent features had a fair value of $1 million and $2 million, respectively. At February 2, 2013, derivative liabilities related to agreements that contain credit-risk related contingent features had a nominal fair value. We are not required to post collateral for these contracts.

The following table sets forth the net impact of the effective portion of derivatives designated as cash flow hedges on Accumulated other comprehensive (loss) income on our Condensed Consolidated Statements of Stockholders' Equity for the thirteen weeks ended May 4, 2013 and April 28, 2012:

	13 Weeks Ended	
(In millions)	May 4, 2013	April 28, 2012
Derivatives designated as cash flow hedges:		
Beginning balance	$(2)	$(2)
Change in fair value recognized in Accumulated other comprehensive (loss) income - Interest Rate Contracts (1)	—	—
Ending balance	$(2)	$(2)

(1) Reclassifications from Accumulated other comprehensive (loss) income to Interest expense were nominal for the thirteen weeks ended May 4, 2013 and April 28, 2012.

The following table sets forth the impact of derivatives on Interest expense on our Condensed Consolidated Statements of Operations for the thirteen weeks ended May 4, 2013 and April 28, 2012:

	13 Weeks Ended	
(In millions)	May 4, 2013	April 28, 2012
Derivatives not designated for hedge accounting:		
Gain on the change in fair value - Interest Rate Contracts	$—	$1
Loss on the change in fair value - Intercompany Loan Foreign Exchange Contracts (1)	(8)	(3)
Gain (loss) on the change in fair value - Merchandise Purchases Program Foreign Exchange Contracts	2	(3)
	(6)	(5)
Derivative designated as a fair value hedge:		
Gain (loss) on the change in fair value - Interest Rate Contract	1	(1)
Gain recognized in interest expense on hedged item	—	2
	1	1
Total Interest expense	$(5)	$(4)

(1) Gains and losses related to our short-term, intercompany loan foreign exchange contracts are recorded in Interest expense, in addition to the corresponding foreign exchange gains and losses related to our short-term, cross-currency intercompany loans.

The following table contains the notional amounts and related fair values of our derivatives included within our Condensed Consolidated Balance Sheets as of May 4, 2013, February 2, 2013 and April 28, 2012:

	May 4, 2013		February 2, 2013		April 28, 2012	
(In millions)	Notional Amount	Fair Value Assets/ (Liabilities)	Notional Amount	Fair Value Assets/ (Liabilities)	Notional Amount	Fair Value Assets/ (Liabilities)
Interest Rate Contracts designated as cash flow hedges:						
Other assets	$859	$—	$802	$—	$700	$—
Accrued expenses and other current liabilities	—	—	3	—	3	—
Other non-current liabilities	83	(1)	89	(1)	123	(2)
Interest Rate Contract designated as a fair value hedge:						
Other assets	350	19	350	18	350	17
Interest Rate Contracts not designated for hedge accounting:						
Other assets	1,611	—	1,611	—	1,611	—
Accrued expenses and other current liabilities	—	—	91	—	344	(6)
Foreign Currency Contracts not designated for hedge accounting:						
Prepaid expenses and other current assets	130	1	122	1	54	1
Accrued expenses and other current liabilities	$287	$(2)	$17	$—	$290	$(3)
Total derivative contracts outstanding:						
Prepaid expenses and other current assets	$130	$1	$122	$1	$54	$1
Other assets	2,820	19	2,763	18	2,661	17
Total derivative assets (1)	$2,950	$20	$2,885	$19	$2,715	$18
Accrued expenses and other current liabilities	$287	$(2)	$111	$—	$637	$(9)
Other non-current liabilities	83	(1)	89	(1)	123	(2)

Total derivative liabilities (1)	$370	$(3)	$200	$(1)	$760	$(11)

(1) Refer to Note 4 entitled “Fair value measurements” for the fair value of our derivative instruments classified within the fair value hierarchy.

Offsetting of Derivatives

We present our derivatives at gross fair values in the Condensed Consolidated Balance Sheets. However, some of our interest rate and foreign exchange contracts are subject to master netting arrangements which allow net settlements under certain conditions. As of May 4, 2013, February 2, 2013 and April 28, 2012, the aggregate gross fair value of derivative liabilities which could be net settled against our derivative assets were nominal, and the aggregate gross fair value of derivative assets which could be net settled against our derivative liabilities were nominal. As of May 4, 2013, February 2, 2013 and April 28, 2012, none of the master netting arrangements involved collateral.

4. Fair value measurements

To determine the fair value of our assets and liabilities, we utilize the established fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity (observable inputs that are classified within Levels 1 and 2 of the hierarchy) and the reporting entity's own assumptions about market participant assumptions (unobservable inputs classified within Level 3 of the hierarchy).

Assets and Liabilities Measured at Fair Value on a Recurring Basis

Derivative Financial Instruments

Currently, we use derivative financial arrangements to manage a variety of risk exposures, including interest rate risk associated with our Long-term debt and foreign currency risk relating to cross-currency intercompany lending and merchandise purchases. The valuation of our foreign currency contracts is determined using market-based foreign exchange rates, which are classified as Level 2 inputs.

The valuation of our interest rate contracts is determined using widely accepted valuation techniques including discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including interest rate curves, foreign exchange rates and implied volatilities. We evaluate the inputs used to value our derivatives at the end of each reporting period.

For our interest rate contracts, we primarily use Level 2 inputs mentioned above to arrive at fair value. Additionally, for interest rate contracts we also incorporate credit valuation adjustments to appropriately reflect both our own nonperformance risk and the respective counterparty's nonperformance risk in the fair value measurements taking into account the impact of any applicable credit enhancements, such as collateral postings, thresholds, mutual puts and guarantees. We measure the credit risk of our derivative financial instruments that are subject to master netting agreements on a net basis by counterparty portfolio. The portfolio-level adjustments are then allocated each period to the individual assets or liabilities within the portfolio.

The credit valuation adjustments are calculated by determining the total expected exposure of the derivatives (which incorporates both the current and potential future exposure) and then applying each counterparty's credit spread to the applicable exposure. The total expected exposure of a derivative is derived using market-observable inputs, such as yield curves and volatilities. The inputs utilized for our own credit spread are based on implied spreads from our debt, which are considered unobservable inputs. These credit valuation adjustments fall within Level 3 of the fair value hierarchy and include estimates of current credit spreads to evaluate the likelihood of default. For counterparties with publicly available credit information, the credit spreads over LIBOR used in the calculations represent implied credit default swap spreads obtained from a third party credit data provider. Generally, significant increases (decreases) in our own credit spread in isolation would result in significantly lower (higher) fair value measurement for these derivatives. Based on the mixed input valuation, we classify these derivatives based on the lowest level in the fair value hierarchy that is significant to the overall fair value of the instrument.

Any transfer into or out of a level of the fair value hierarchy is recognized based on the value of the instruments at the end of the reporting period.

Cash Equivalents

Cash equivalents include highly liquid investments with an original maturity of three months or less at acquisition. Due to the nature and short maturity of these investments, their carrying amount approximates fair value. Therefore, we have determined that our cash equivalents in their entirety are classified as Level 1 within the fair value hierarchy.

The table below presents our assets and liabilities measured at fair value on a recurring basis as of May 4, 2013, February 2, 2013 and April 28, 2012, aggregated by level in the fair value hierarchy within which those measurements fall.

(In millions)	Quoted Prices in Active Markets for Identical Assets and Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at May 4, 2013
Assets				
Cash equivalents	$ 205	$—	$—	$205
Derivative financial instruments:				
Interest rate contracts	—	19	—	19
Foreign exchange contracts	—	1	—	1
Total assets	$ 205	$ 20	$—	$225
Liabilities				
Derivative financial instruments:				
Interest rate contracts	$ —	$ 1	$—	$ 1
Foreign exchange contracts	—	2	—	2
Total liabilities	$ —	$ 3	$—	$ 3

(In millions)	Quoted Prices in Active Markets for Identical Assets and Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at February 2, 2013
Assets				
Cash equivalents	$ 667	$—	$—	$667
Derivative financial instruments:				
Interest rate contracts	—	18	—	18
Foreign exchange contracts	—	1	—	1
Total assets	$ 667	$ 19	$—	$686
Liabilities				
Derivative financial instruments:				
Interest rate contracts	$ —	$ 1	$—	$ 1
Foreign exchange contracts	—	—	—	—
Total liabilities	$ —	$ 1	$—	$ 1

(In millions)	Quoted Prices in Active Markets for Identical Assets and Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at April 28, 2012
Assets				
Cash equivalents	$ 210	$—	$—	$210
Derivative financial instruments:				
Interest rate contracts	—	17	—	17
Foreign exchange contracts	—	1	—	1
Total assets	$ 210	$ 18	$—	$228
Liabilities				
Derivative financial instruments:				
Interest rate contracts	$ —	$ 2	$6	$8

Foreign exchange contracts	—	3	—	3
Total liabilities	$ —	$ 5	$ 6	$ 11

For the thirteen weeks ended May 4, 2013, we had no derivative financial instruments within Level 3 of the fair value hierarchy. The table below presents the changes in the fair value of our derivative financial instruments within Level 3 of the fair value hierarchy for the thirteen weeks ended April 28, 2012.

(In millions)	Level 3
Balance, January 28, 2012	$(7)
Gain on the change in fair value	1
Balance, April 28, 2012	$(6)

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

Certain of our assets and liabilities are measured at fair value on a nonrecurring basis. We evaluate the carrying value of all long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. The fair value measurements related to long-lived assets held and used and held for sale classified as Level 3 were determined using a discounted cash flow valuation method. For those assets classified as Level 2 a relative, market-based approach based on offers was utilized.

There have been no changes in valuation technique or related inputs for the thirteen weeks ended May 4, 2013 and April 28, 2012.

The table below presents our long-lived assets evaluated for impairment measured at fair value on a nonrecurring basis for the thirteen weeks ended May 4, 2013 and April 28, 2012, aggregated by level in the fair value hierarchy within which those measurements fall. Because these assets are not measured at fair value on a recurring basis, certain carrying amounts and fair value measurements presented in the table may reflect values at earlier measurement dates and may no longer represent their fair values at May 4, 2013 and April 28, 2012. As of May 4, 2013 and April 28, 2012, we did not have any long-lived assets classified as Level 1 within the fair value hierarchy.

(In millions)	Carrying Value Prior to Impairment	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Impairment Losses
Long-lived assets held and used	$9	$6	$1	$2
Balance, May 4, 2013	$9	$6	$1	$2

(In millions)	Carrying Value Prior to Impairment	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Impairment Losses
Long-lived assets held and used	$4	$2	$—	$2
Balance, April 28, 2012	$4	$2	$—	$2

5. Income taxes

The following table summarizes our income tax benefit and effective tax rates for the thirteen weeks ended May 4, 2013 and April 28, 2012:

	13 Weeks Ended	
($ In millions)	May 4, 2013	April 28, 2012
Loss before income taxes	$(184)	$(98)
Income tax benefit	73	38
Effective tax rate	(39.7)%	(38.8)%

The effective tax rates for the thirteen weeks ended May 4, 2013 and April 28, 2012 were based on our forecasted annualized effective tax rates, adjusted for discrete items that occurred within the periods presented. Our forecasted annualized effective tax rate is 38.9% for the thirteen weeks ended May 4, 2013 compared to 40.3% for the same period last year. The difference between our forecasted annualized effective tax rates was primarily due to a change in the mix and level of earnings between jurisdictions.

For the thirteen weeks ended May 4, 2013, our effective tax rate was impacted by a tax benefit of $2 million related to adjustments to taxes payable. This tax benefit was partially offset by a tax expense of $1 million related to state income taxes.

For the thirteen weeks ended April 28, 2012, our effective tax rate was impacted by tax expense of approximately $1 million related to changes to our liability for uncertain tax positions.

6. Segments

Our reportable segments are Toys "R" Us – Domestic ("Domestic"), which provides toy and juvenile (including baby) product offerings in 49 states and Puerto Rico, and Toys "R" Us – International ("International"), which operates or licenses "R" Us branded retail stores in 35 foreign countries and jurisdictions with operated stores in Australia, Austria, Brunei, Canada, China, France, Germany, Hong Kong, Japan, Malaysia, Poland, Portugal, Singapore, Spain, Switzerland, Taiwan, Thailand and the United Kingdom. Domestic and International segments also include their respective Internet operations. Segment operating earnings (loss) excludes corporate related charges and income. All intercompany transactions between the segments have been eliminated. Income tax information by segment has not been included as taxes are calculated at a company-wide level and are not allocated to each segment. Revenues from external customers are derived primarily from merchandise sales and we do not rely on any major customers as a source of revenue.

Our percentages of consolidated Net sales by product category for the thirteen weeks ended May 4, 2013 and April 28, 2012 were as follows:

	13 Weeks Ended			
Domestic:	May 4, 2013		April 28, 2012	
Core Toy	11.7	%	11.3	%
Entertainment	7.3	%	8.3	%
Juvenile	51.0	%	51.0	%
Learning	16.4	%	15.4	%
Seasonal	13.0	%	13.2	%
Other (1)	0.6	%	0.8	%
Total	100	%	100	%

(1) Consists primarily of non-product related revenues.

	13 Weeks Ended			
International:	May 4, 2013		April 28, 2012	
Core Toy	19.3	%	18.9	%
Entertainment	9.1	%	9.3	%
Juvenile	26.8	%	28.2	%
Learning	26.4	%	24.7	%
Seasonal	17.5	%	18.1	%
Other (1)	0.9	%	0.8	%
Total	100	%	100	%

(1) Consists primarily of licensing fees from unaffiliated third parties and other non-product related revenues.

From time to time, we may make revisions to our prior period Net sales by product category to conform to the current period allocation. These revisions did not have a significant impact to our prior year disclosure.

A summary of financial results by reportable segment is as follows:

	13 Weeks Ended	
(In millions)	May 4, 2013	April 28, 2012
Net sales		
Domestic	$1,480	$1,618
International	928	994
Total Net sales	$2,408	$2,612
Operating earnings (loss)		
Domestic	$40	$100
International	(28)	(14)
Corporate and other	(85)	(76)
Operating (loss) earnings	(73)	10
Interest expense	(114)	(112)
Interest income	3	4
Loss before income taxes	$(184)	$(98)

(In millions)	May 4, 2013	February 2, 2013	April 28, 2012
Merchandise inventories			