TOYS R US INC
Form 10-Q
December 12, 2006
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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 October 28, 2006

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 x   No ¨

Indicate by checkmark whether the registrant is a large accelerated filer, an accelerated filer, or 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 x

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

As of December 11, 2006 there were outstanding 1,000 shares of common stock of Toys R Us, Inc. (all of which are owned by Toys R Us Holdings, Inc., our holding company, and are not publicly traded).

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TOYS R US, INC. AND SUBSIDIARIES

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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)

	October 28, 2006	January 28, 2006	October 29, 2005
ASSETS			
Current Assets:			
Cash and cash equivalents	**$ 393**	$ 981	$ 324
Accounts and other receivables	**142**	218	158
Merchandise inventories	**3,073**	1,488	3,063
Assets held for sale	**11**		5
Prepaid expenses, current deferred tax assets and other current assets	**315**	216	172
Total current assets	**3,934**	2,903	3,722
Property and equipment, net	**4,331**	4,175	4,261
Goodwill, net	**365**	359	353
Deferred tax assets	**610**	457	653
Restricted cash	**151**	107	
Other assets	**518**	365	381
	$ 9,909	$ 8,366	$ 9,370
LIABILITIES AND STOCKHOLDERS DEFICIT			
Current Liabilities:			
Short-term borrowings	**$ 285**	$	$
Accounts payable	**1,619**	1,118	1,499
Accrued expenses and other current liabilities	**834**	900	751
Income taxes payable	**107**	130	95
Current portion of long-term debt	**65**	407	453
Total current liabilities	**2,910**	2,555	2,798
Long-term debt	**6,716**	5,540	6,331
Deferred tax liabilities	**507**	531	629
Deferred rent liabilities	**258**	260	276
Other non-current liabilities	**265**	204	195
Minority interest in Toys R Us Japan	**131**		
Stockholders deficit:			
Additional paid in capital	**3**		
Deficit	**(783)**	(669)	(811)
Accumulated other comprehensive loss	**(98)**	(55)	(48)
Total Stockholders deficit	**(878)**	(724)	(859)
	$ 9,909	$ 8,366	$ 9,370

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		39 Weeks Ended	
	October 28, 2006	**October 29, 2005**	**October 28, 2006**	**October 29, 2005**
Net sales	**$ 2,517**	$ 2,157	**$ 7,319**	$ 6,388
Cost of sales	**1,673**	1,463	**4,813**	4,226
Gross margin	**844**	694	**2,506**	2,162
Selling, general and administrative expenses	**785**	678	**2,228**	1,980
Depreciation and amortization	**92**	86	**305**	269
Net gains on sales of properties	**(109)**		**(109)**	
Restructuring (reversals) charges and other	**(1)**	(1)	**4**	4
Transaction and related costs		2		402
Loss on early extinguishment of debt and contract settlement fees				22
Total operating expenses	**767**	765	**2,428**	2,677
Operating earnings (loss)	**77**	(71)	**78**	(515)
Other (expense) income:				
Interest expense	**(141)**	(125)	**(401)**	(211)
Interest income	**4**	2	**17**	22
Loss before income taxes and minority interest	**(60)**	(194)	**(306)**	(704)
Income tax benefit	**82**	68	**184**	178
Minority interest	**7**		**8**	
Net income (loss)	**$ 29**	$ (126)	**$ (114)**	$ (526)

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)

(In millions)

	39 Weeks Ended	
	October 28, 2006	**October 29, 2005**
Cash Flows from Operating Activities:		
Net loss	**$ (114)**	$ (526)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	**305**	269
Amortization of restricted stock		16
Amortization of debt issuance costs and swap unwind	**46**	15
Net gains on sales of properties	**(109)**	
Stock compensation expense arising from cash settlement		195
Deferred income taxes	**(200)**	(81)
Tax benefit from exercise of stock options		16
Stock option compensation expense	**3**	17
Proceeds received from settlement of derivatives	**9**	38
Non-cash portion of restructuring and other charges	**8**	
Other	**(13)**	18
Changes in operating assets and liabilities:		
Accounts and other receivables	**106**	10
Merchandise inventories	**(1,366)**	(1,195)
Prepaid expenses and other operating assets	**(34)**	15
Accrued expenses and other liabilities	**(113)**	(140)
Accounts payable	**264**	495
Income taxes payable	**(30)**	(149)
Net cash used in operating activities	**(1,238)**	(987)
Cash Flows from Investing Activities:		
Capital expenditures	**(170)**	(227)
Increase in restricted cash	**(44)**	
Acquisition of minority interest in Toysrus.com	**(6)**	
Cash effect of the consolidation of Toys-Japan	**6**	
Proceeds from sales of short-term investments		953
Proceeds from sales of fixed assets and properties	**217**	4
Net cash provided by investing activities	**3**	730
Cash Flows from Financing Activities:		
Long-term debt borrowings	**3,298**	4,801
Short-term debt borrowings	**126**	325
Long-term debt repayment	**(2,743)**	(490)
Short-term debt repayment	**(25)**	(174)
Dividends paid to Toys Japan minority interest	**(5)**	
Repurchase of common stock		(5,891)
Repurchase of stock options and restricted stock		(225)
Capital contributed by affiliate		1,279

Settlement of equity security units		(130)
Proceeds received from exercise of stock options		87
Proceeds received from issuance of common stock		20
Capitalized debt issuance costs	**(42)**	(213)
Net cash provided by (used in) financing activities	**609**	(611)
Effect of exchange rate changes on cash and cash equivalents	**38**	(40)
Cash and cash equivalents:		
Net decrease during period	**(588)**	(908)
Cash and cash equivalents at beginning of period	**981**	1,232
Cash and cash equivalents at end of period	**$ 393**	$ 324

See accompanying notes to the condensed consolidated financial statements.

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TOYS R US, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Basis of presentation

Except as expressly indicated or unless the context otherwise requires, as used herein, the Company, we, us, or our means Toys R Us, Inc. and its subsidiaries. The condensed consolidated balance sheets as of October 28, 2006, January 28, 2006, and October 29, 2005, the condensed consolidated statements of operations for the thirteen weeks and thirty-nine weeks ended October 28, 2006 and October 29, 2005, and the condensed consolidated statements of cash flows for the thirty-nine weeks ended October 28, 2006 and October 29, 2005 have been prepared by us in conformity with accounting principles generally accepted in the United States (GAAP) for interim reporting and in accordance with the requirements of Form 10-Q. Our interim condensed consolidated financial statements are unaudited and are subject to year-end adjustments. In the opinion of management, the consolidated 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 and thirty-nine weeks then ended. The balance sheet at January 28, 2006, presented herein, has been derived from our audited balance sheet included in our Annual Report on Form 10-K for the fiscal year ended January 28, 2006.

The results of operations for the thirteen weeks and thirty-nine weeks ended October 28, 2006 and October 29, 2005 are not necessarily indicative of operating results of the full year.

Beginning with the first quarter of fiscal 2006, we consolidated Toys R Us Japan, Ltd. (Toys Japan) into our consolidated financial statements. Toys Japan had been previously accounted for using the equity method of accounting. As a result, the amounts in our consolidated financial statement captions are not comparable. For further details refer to Note 6 entitled Investment in Toys Japan .

During the third quarter of 2006, we reorganized our operations, resulting in Toysrus.com being reflected as part of our Toys R Us-U.S. segment. As a result of this reorganization, our current reportable segments are Toys R Us-U.S., Toys R Us-International and Babies R Us. Prior year information has been restated to reflect the current segment structure. See Note 13 entitled Segments .

We revised the October 29, 2005 balance sheet to reclassify $44 million of accrued freight charges from merchandise inventories to accrued expenses and other current liabilities.

Certain information and footnote disclosures normally included in the annual audited financial statements prepared in accordance with GAAP have been omitted. These interim condensed consolidated financial statements should be read in conjunction with our audited consolidated financial statements and footnotes thereto included in our Annual Report on Form 10-K for the fiscal year ended January 28, 2006.

2. Merger transaction

On July 21, 2005, we were acquired by an investment group consisting of entities advised by or affiliated with Bain Capital Partners LLC, Kohlberg Kravis Roberts & Co., L.P., and Vornado Realty Trust (collectively, the Sponsors) along with a fourth investor, GB Holdings I, LLC, an affiliate of Gordon Brothers, a consulting firm that is independent from and unaffiliated with the Sponsors and management (the Sponsors and GB Holdings I, LLC are collectively referred to herein as the Investors). The acquisition was consummated through a $6.6 billion merger of the Company into Global Toys Acquisition Merger Sub, Inc. (Acquisition Sub) with the Company being the surviving corporation in the merger (the Merger) pursuant to an Agreement and Plan of Merger, dated as of March 17, 2005 (the Merger Agreement), among the Company, Global Toys Acquisition, LLC (Parent) and Acquisition Sub.

Under the Merger Agreement, the former holders of the Company s common stock, par value $.10 per share, received $26.75 per share, or approximately $5.9 billion. In addition, approximately $766 million was used to settle our equity security units, cash out our warrants and options to purchase common stock, settle restricted stock and restricted stock units, pay fees and expenses related to the Merger, and make severance payments and related payroll taxes.

3. Net gains on sales of properties

In the third quarter of 2006, Toys R Us-Delaware, Inc. (Toys-Delaware), a wholly-owned direct subsidiary of the Company, and MAP 2005 Real Estate, LLC (MAP), a Delaware limited liability company of which the Company is the sole member (Toys-Delaware and MAP are collectively referred to herein as Seller), consummated part of the previously announced sale of its interest in 44 properties to Vornado Surplus 2006 Realty LLC, a Delaware limited liability company (the Purchaser), an affiliate of Vornado

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Realty Trust, an indirect equity owner of the Company and the Seller (see Note 4 Restructuring and other charges 2005 Initiatives). During this period, we sold 38 properties for gross proceeds of approximately $178 million. As a result of the sale of these properties, the Company recorded a gain of $91 million for the thirteen weeks and thirty-nine weeks ended October 28, 2006. Approximately $156 million of the proceeds were used to repay a portion of the $200 million asset sale facility of the new senior secured credit facilities Toys-Delaware entered into on July 19, 2006 (see Note 9 entitled Seasonal financing and long-term debt).

The sale of all or a portion of the remaining six properties, which are part of the previously announced sale, is expected to close by the end of the Company s first fiscal quarter of 2007. As such, the remaining six properties to be sold are included in assets held for sale on the condensed consolidated balance sheet.

In addition, during the third quarter of 2006, Toys R Us Properties (UK) Limited sold its interest in and assets related to a leased property in Cardiff, U.K. to an unrelated third party for gross proceeds of approximately $26 million, resulting in a gain of $20 million for the thirteen weeks and thirty-nine weeks ended October 28, 2006.

4. Restructuring and other charges

Our condensed consolidated financial statements for the thirteen and thirty-nine weeks ended October 28, 2006 and October 29, 2005 included the following pre-tax charges related to restructuring initiatives :

	Restructuring and other charges		Depreciation and amortization		Cost of Sales		SG&A		Total	
(In millions)	**October 28, 2006**	**October 29, 2005**	**October 28, 2006**	**October 29, 2005**	**October 28, 2006**	**October 29, 2005**	**October 28, 2006**	**October 29, 2005**	**October 28, 2006**	**October 29, 2005**
13 Weeks Ended										
2005 Initiatives	**$ (4)**	$	**$**	$	**$**	$	**$**	$	**$ (4)**	$
2004 and Prior Year Initiatives	**$ 3**	$ (1)	**$**	$	**$**	$	**$**	$	**$ 3**	$ (1)
Total	**$ (1)**	$ (1)	**$**	$	**$**	$	**$**	$	**$ (1)**	$ (1)
39 Weeks Ended										
2005 Initiatives	**$ 2**	$	**$ 24**	$	**$ 3**	$	**$**	$	**$ 29**	$
2004 and Prior Year Initiatives	**2**	4						5	**2**	9
Total	**$ 4**	$ 4	**$ 24**	$	**$ 3**	$	**$**	$ 5	**$ 31**	$ 9

At October 28, 2006, we had total remaining reserves of $77 million related to the restructuring initiatives explained below. We believe that the remaining reserves at October 28, 2006 are adequate to complete these initiatives and commitments. See below for a further discussion of individual restructuring initiatives and a roll-forward of the related charges and reserves.

(In millions)	**Balance at January 28, 2006**	**Charges**	**Reclassification (1)**	**Reversals**	**Utilized**	**Balance at October 28, 2006**
2005 Initiatives	$ 43	$ 33	$ 12	$ (4)	$ (74)	$ 10
2004 and Prior Year Initiatives	82	3		(1)	(17)	67
Total	$ 125	$ 36	$ 12	$ (5)	$ (91)	$ 77

(1) Reclassification of straight-line lease reserves recorded in prior periods related to the restructured properties.

2005 Initiatives

On January 5, 2006, our Board of Directors approved the closing of 87 Toys R Us stores in the United States. By the end of the first quarter 2006, all 87 stores had been closed. Twelve of these stores have been converted into Babies R Us stores, resulting in the permanent closing of 75

store locations, of which 38 were sold to Vornado as of October 28, 2006, with 6 additional properties expected to be sold to Vornado in the first quarter of 2007 (see Note 3 entitled Net gains on sales of properties).

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For the thirteen weeks ended October 28, 2006, we reversed $4 million of reserves primarily for previously recorded lease commitments on properties sold during the third quarter of 2006.

For the thirty-nine weeks ended October 28, 2006, we incurred gross charges of $33 million, and reversed $4 million of severance charges and lease commitments related to this initiative. The $33 million of charges included $3 million of inventory markdowns and liquidator fees that were recorded in cost of sales, and $24 million of accelerated depreciation related to the closed and converted stores. The remaining $6 million of costs and charges, included in restructuring and other charges in the condensed consolidated statement of operations, consisted of $5 million relating to lease commitments and $1 million relating to asset impairment of fixed assets and disposal charges. These charges were partially offset by the reversal of $3 million of lease commitments on properties sold and $1 million of severance charges that we determined were no longer needed. As a result of the store closings, approximately 3,000 employee positions have been eliminated.

Details on the activity of charges and reserves for the thirty-nine weeks ended October 28, 2006 are as follows:

(In millions)	Balance at January 28, 2006	Charges	Reclassifications [1]	Reversals	Utilized	Balance at October 28, 2006
Lease commitments	$ 1	$ 5	$ 12	$ (3)	$ (6)	**$ 9**
Asset impairment and disposal charges		1			(1)	
Accelerated depreciation		24			(24)	
Inventory markdowns and disposal charges	34	3			(37)	
Severance	8			(1)	(6)	**1**
Total	$ 43	$ 33	$ 12	$ (4)	$ (74)	**$ 10**

[1] Reclassification of straight-line lease reserves recorded in prior periods related to the restructured properties.

2004 and Prior Year s Initiatives

In fiscal 2004, we recorded termination costs relating to the restructuring of the Global Store Support Center operations in Wayne, New Jersey. During the thirty-nine weeks ended October 28, 2006, we utilized the final $1 million of reserves related to severance and other compensation and no further obligations exist regarding these initiatives.

In fiscal 2003, we decided to close all 146 of the freestanding Kids R Us stores and all 36 of the free-standing Imaginarium stores, as well as three distribution centers that support these stores. During the thirty-nine weeks ended October 28, 2006, we incurred $3 million of charges and reversed $1 million of charges for disposal of fixed assets and lease commitments, and utilized $5 million of reserves related to lease commitments. At October 28, 2006, we had $5 million of reserves remaining for lease commitments.

In fiscal 2001, we closed stores, eliminated a number of staff positions, and consolidated five store support center facilities into our Global Store Support Center facility in Wayne, New Jersey. During the thirty-nine weeks ended October 28, 2006, we utilized $7 million of outstanding reserves for this initiative. At October 28, 2006, we had $44 million of reserves remaining for lease commitments related to stores and store support center locations.

We had $18 million of reserves remaining at October 28, 2006, related to long-term lease commitments from restructuring charges previously recorded in 1998 and 1995, which will be utilized for the remainder of 2006 and thereafter. During the thirty-nine weeks ended October 28, 2006, we utilized $4 million of reserves for lease shortfalls.

For the thirty-nine weeks ended October 29, 2005, we incurred $9 million of charges. Five million dollars of these charges were stock option compensation charges that were recorded in selling, general and administrative expenses, as part of our 2004 restructuring reserves. The remaining $4 million were charges related to 2004 and earlier initiatives that were recorded in restructuring and other charges.

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Assets held for sale

As a result of our 2005 and prior year s initiatives, the following assets are classified as current assets held for sale:

(In millions)	October 28, 2006
Land	$ 5
Buildings	5
Leasehold improvements	5
	15
Less: accumulated depreciation and amortization	4
Net property assets held for sale	$ 11

5. Merchandise inventories

Merchandise inventories for the Toys R Us U.S. division, other than apparel, are stated at the lower of LIFO (last-in, first-out) cost or market value, as determined by the retail inventory method, and represented approximately 49% of total merchandise inventories as of October 28, 2006. Merchandise inventories for our other divisions and apparel are stated at the lower of FIFO (first-in, first-out) cost or market value, as determined by the retail inventory method. If all inventories had been valued at the lower of FIFO cost or market, inventories would show no change at October 28, 2006, January 28, 2006 or October 29, 2005. Details on the components of our consolidated merchandise inventories are as follows:

(In millions)	October 28, 2006	January 28, 2006	October 29, 2005
Toys R Us U.S.	**$ 1,631**	$ 763	$ 2,011
Toys R Us International	**1,104**	402	743
Babies R Us	**338**	323	309
Total	**$ 3,073**	$ 1,488	$ 3,063

6. Investment in Toys - Japan

We own a 47.9% ownership investment in the common stock of Toys-Japan. During the first quarter of 2006, we (together with our Sponsors) took control of a majority of the board of directors of Toys-Japan. As a result of this control, our ownership in Toys-Japan and other factors, we have consolidated the results of Toys-Japan into our condensed consolidated financial statements for all periods of fiscal 2006. We had previously accounted for our investment in Toys-Japan using the equity method of accounting.

We currently guarantee 80% of Toys-Japan s three installment loans from a third party in Japan, totaling 5.6 billion yen ($48 million). These loans have annual interest rates of 2.6% 2.8% and are due from 2012 to 2014 and are reported as part of the Toys R Us-Japan, Ltd. Bank loans of $156 million at October 28, 2006. See Note 9 entitled Seasonal financing and long-term debt .

During the thirteen weeks ended October 28, 2006 and October 29, 2005, Toys-Japan had net sales of $342 million and $355 million, respectively. During the thirty-nine weeks ended October 28, 2006 and October 29, 2005, Toys-Japan had net sales of $1,018 million and $1,043 million, respectively. The consolidation of Toys-Japan had no material impact on our net income (loss) for the thirteen and thirty-nine weeks ended October 28, 2006.

7. Derivative instruments and hedging activities

Statement of Financial Accounting Standards (SFAS) No. 133 (SFAS No. 133), as amended, establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. It requires the recording of all derivatives as either assets or liabilities on the balance sheet measured at estimated fair value and the recognition of the unrealized gains and losses. We record the fair market value of our derivatives, based on information provided by reliable third parties, as other assets and other liabilities within our consolidated balance sheets. The changes in fair value of derivatives are recorded in consolidated statement of operations, unless the derivative is designated as a hedge. In certain defined conditions, a derivative may be specifically designated as a hedge for a particular exposure. The effective portion of a hedge is

recorded to other comprehensive income or loss; the ineffective portion of a hedge is recorded to interest income or interest expense. The accounting for derivatives depends on the intended use of the derivatives and the resulting designation.

We enter into derivative financial arrangements to hedge a variety of risk exposures, including interest rate risk associated with our long-term debt and foreign currency risk relating to import merchandise purchases. We enter into interest rate swaps and/or caps to manage interest rate risk. We enter into foreign exchange forward contracts to minimize and manage the currency risks associated with the settlement of payables related to our merchandise import program.

Derivatives related to our import program are not designated as hedges under SFAS No.133. As a result, changes in value of these derivatives are recorded to the consolidated statement of operations. For the quarter ending October 28, 2006, we recorded $1 million to consolidated statement of operations for derivatives related to the import program.

In July 2006, we entered into interest rate corridors on our $1.3 billion unsecured real estate loan and our $800 million secured real estate loans. The interest rate corridors on our $1.3 billion unsecured real estate loan are considered hedges of the variable cash flows associated with changes in one month LIBOR above 5.50% and below 7.50%. The interest rate corridors on our $800 million secured real estate loans are considered economic hedges of the variable cash flows associated with changes in one month LIBOR above 5.50% and below 7.00%. We paid $10 million to enter into the interest rate corridors. At October 28, 2006, the change in fair value of these derivatives from January 28, 2006 was $8 million.

In July 2006, we entered into interest rate swaps and an interest rate cap on $600 million of debt outstanding under the secured term loan facility that is part of the Secured Credit Facilities (described in Note 9 entitled Seasonal financing and long-term debt) we entered into on July 19, 2006. The interest rate swaps hedge the variable LIBOR for a fixed rate of interest of 5.435% plus the credit spread until August 2008. The interest rate cap has an effective date of August 2008 and hedges the variable cash flows associated with changes in the three month LIBOR above 7.50% through August 2010. Both the swaps and the cap are designated as cash flow hedges under the long-haul method, whereby the Company evaluates the effectiveness of the hedging relationships on an ongoing basis and recalculates changes in fair value of the derivatives and related hedged items independently. At October 28, 2006, the change in fair value of these derivatives from January 28, 2006 was approximately $5 million, which was recorded to other comprehensive loss. A derivative liability of $4 million and a derivative asset of less than $1 million was recorded related to the interest rate swaps and interest rate cap, respectively. No material ineffectiveness existed at October 28, 2006.

In February 2006, we either terminated or amended three interest rate swaps and initiated three new or amended interest rate swaps to hedge exposure related to the French, Spanish and United Kingdom real estate financing transactions entered into in January and February 2006 (see Note 9, entitled Seasonal financing and long-term debt). At the time of these transactions, the Company de-designated the old swaps that were previously classified as cash flow hedges for the anticipated European Property Financings. As a result of the termination of the swaps, the Company received $8 million, out of which $1 million was recorded to interest income and $7 million will be amortized over the life of the related debt. The Company paid $7 million to enter into the new swaps. These new swaps hedge the variable LIBOR and EURIBOR rates for notional amounts that include £62 million and 200 million for fixed rates of interest at 4.56% for the British pound denominated swaps and 3.01% for the euro denominated swaps. In these hedging relationships, we are hedging the LIBOR/EURIBOR component, which is generally 3-month LIBOR/EURIBOR. Payments to be received (or paid) under the swap contract will offset the fluctuations in debt interest expense caused by changes in the relevant LIBOR/EURIBOR index. The instruments are designated as cash flow hedges of the variable cash flows associated with changes in the three month LIBOR and EURIBOR under the long-haul method, whereby the Company evaluates the effectiveness of the hedging relationships on an ongoing basis and recalculates changes in fair value of the derivatives and related hedged items independently. In July 2006, the Company re-designated these cash flow hedges to improve the hedge documentation. At October 28, 2006, the Company performed an assessment for both UK and France hedges, and both were found to be ineffective; as a result, less than $1 million was recorded to interest income for the quarter. The Spain hedge was considered highly effective; the amount of ineffectiveness recorded to interest income was less than $1 million. At October 28, 2006, the fair value of the swaps was $15 million recorded as a long-term derivative asset.

In December 2005, we entered into interest rate caps on our $1.3 billion unsecured real estate loan. The interest rate caps are considered hedges of the variable cash flows associated with changes in one month LIBOR above 7.50% and are designated as cash flow hedges under the long-haul method. At October 28, 2006, the change in fair value of the interest rate caps from January 28, 2006 was $1 million, which was recorded to other comprehensive loss. There was no material ineffectiveness.

In July 2005, we entered into interest rate caps on our $800 million secured real estate loans. The interest rate caps are considered hedges of the variable cash flow associated with changes in one month LIBOR above 7.00% and are designated as cash flow hedges under the long-haul method. At October 28, 2006, the change in fair value of the caps from January 28, 2006 was immaterial and no material ineffectiveness existed at October 28, 2006.

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8. Goodwill

Details on goodwill by reporting segment are as follows:

(In millions)	October 28, 2006	January 28, 2006	October 29, 2005
Toys R Us U.S.	**$ 40**	$ 40	$ 34
Toys R Us International	**6**		
Babies R Us	**319**	319	319
Total	**$ 365**	$ 359	$ 353

The $6 million of goodwill for Toys R Us International is related to the consolidation of Toys-Japan (described under Note 6 entitled Investment in Toys-Japan).

9. Seasonal financing and long-term debt

A summary of the Company s long-term debt and seasonal financing is outlined in the table below:

(In millions)	October 28, 2006	January 28, 2006	October 29, 2005
LIBOR plus 1.50% European senior facility, due fiscal 2006-2011		1,008	1,035
6.875% notes, due 8/1/2006 (a)		250	251
LIBOR plus 1.30% secured real estate loans, due August 9, 2007 (b)	**800**	800	800
Note at an effective cost of 2.23% due in semi-annual installments through fiscal 2008 (c)	**50**	81	82
LIBOR plus 3.00%-4.00% asset sale facility, due fiscal 2008	**44**		
LIBOR plus 3.0% unsecured credit agreement, due fiscal 2008	**1,300**	1,300	
LIBOR plus 1.50%-2.0% multi-currency revolving credit facility, due fiscal 2010	**190**		
LIBOR plus 1.0%-3.75% $2.0 billion secured revolving credit facility, due fiscal 2010	**836**		1,160
7.625% notes, due fiscal 2011	**523**	527	528
LIBOR plus 4.25% secured term loan facility, due fiscal 2012	**800**		
LIBOR plus 5.25% unsecured bridge facility, due fiscal 2012		973	1,900
4.51% French real estate credit facility, due fiscal 2013	**82**		
4.51% Spanish real estate credit facility, due fiscal 2013	**171**		
5.02% U.K. real estate credit facility, due fiscal 2013	**675**		
6.81% U.K. real estate credit facility, due fiscal 2013	**118**		
7.875% notes, due fiscal 2013	**390**	389	389
Toys R Us-Japan, Ltd. 1.20%-2.80% bank loans due 2010 - 2014	**156**		
7.375% notes, due fiscal 2018	**408**	408	408
8.75% debentures, due fiscal 2021 (d)	**199**	199	199
Other	**39**	12	32
	6,781	5,947	6,784
Less current portion	**65**	407	453
Total	**$ 6,716**	$ 5,540	$ 6,331

(a) On August 1, 2006, we paid down our $250 million aggregate principal amount of our 6.875% notes, which were due on that day. We funded this payment primarily with cash on hand from previous borrowings.

(b) We have classified this loan as long-term debt as we have the ability and intent to extend the due date to August 9, 2008.

(c) Amortizing note secured by the expected future yen cash flows from license fees due from Toys-Japan.

(d) On December 1, 2006 we repurchased $178 million of the outstanding 8.75% debentures in a cash tender offer for any and all outstanding 8.75% debentures (the Tender Offer) using borrowings under the new unsecured senior credit facilities. We have classified this debenture as long-term debt as we have the ability and intent to extend the due date to January 19, 2013. See Note 18 entitled Subsequent events for a description of the 2021 Tender Offer and $181 million unsecured senior credit facilities for further information.

All of the borrowings under our $800 million secured real estate loans, $50 million note, $44 million asset sale facility, $1.3 billion unsecured credit agreement facility, £95 million and 145 million multi-currency revolving credit facility ($190 million), $2 billion secured revolving credit facility ($836 million), $804 million secured term loan facility ($800 million), 65.2 million ($82 million) French real estate credit facility, 135.1 million ($171 million) Spanish real estate credit facility, £355.8 million ($675 million)

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and £62.4 million ($118 million) United Kingdom real estate credit facilities, as well as $32 million of the $39 million debt included in Other were incurred by our subsidiaries. In addition, $156 million of bank loans and $5 million of Other are obligations of Toys-Japan; and $199 million aggregate principal amount of 8.75% debentures due fiscal 2021 are obligations of Toys R Us, Inc. and our subsidiary, Toys R Us-Delaware, Inc. All of the other obligations described in the table above are obligations of Toys R Us, Inc.

As of October 28, 2006, we were in compliance with our financial covenants related to our outstanding debt.

65.2 Million ($82 Million) French Real Estate Credit Facility

On January 23, 2006, Toys R Us France Real Estate SAS, our indirect wholly-owned subsidiary, entered into a secured loan agreement with a syndicate of financial institutions. The loan is secured by, among other things, selected French real estate, which was acquired by the borrower. On February 1, 2006, the loan agreement was drawn down, and we borrowed the full amount of 65.2 million under the loan agreement. The maturity date for the loan is February 1, 2013. The loan has an interest rate of 1.50% plus mandatory costs plus EURIBOR. We have entered into hedging arrangements whereby we have effectively fixed the interest rate under the loan at 4.505% plus mandatory costs per annum. The loan agreement contains covenants that restrict the ability of the borrower to engage in mergers or consolidations, incur additional indebtedness, or create or permit liens on assets. The loan agreement also requires Toys R Us France Real Estate SAS to maintain an interest coverage ratio of 110%.

135.1 Million ($171 Million) Spanish Real Estate Credit Facility

On January 23, 2006, Toys R Us Iberia Real Estate, S.L., our indirect wholly-owned subsidiary, entered into a secured loan agreement with a syndicate of financial institutions. The loan is secured by, among other things, selected Spanish real estate, which was acquired by the borrower. On February 1, 2006, we borrowed the full amount of 135.1 million under the loan agreement. The maturity date for the loan is February 1, 2013. The loan has an interest rate of 1.50% plus mandatory costs plus EURIBOR. We have entered into hedging arrangements whereby we have fixed the interest rate under the loan at 4.505% plus mandatory costs per annum. The loan agreement contains covenants that restrict the ability of the borrower to engage in mergers or consolidations, incur additional indebtedness, or create or permit liens on assets. The loan also requires Toys R Us Iberia Real Estate, S.L. to maintain an interest coverage ratio of 110%.

£355.8 Million ($675 Million) and £62.4 Million ($118 Million) U.K. Real Estate Credit Facilities

On February 8, 2006, Toys R Us Properties (UK) Limited (Toys Properties), our indirect wholly-owned subsidiary, entered into a credit agreement with Vanwall Finance PLC as the Issuer and as Senior Lender and The Royal Bank of Scotland PLC as Junior Lender, which included a series of Secured Senior Loans comprising an initial principal amount of approximately £347.0 million and a Junior Loan comprising an initial principal amount of up to £62.4 million. The Senior Lender and Junior Lender have also agreed to provide an aggregate of approximately £10.8 million in additional loans under specified conditions, of which £8.8 million was pre-funded under the Senior Loan. The loans are secured by, among other things, selected UK real estate, which was acquired by the borrower. The credit agreement contains covenants that restrict the ability of Toys Properties to incur certain additional indebtedness, create or permit liens on assets, dispose of or acquire further property, vary or terminate the lease agreements, conclude further leases or engage in mergers or consolidations. The credit agreement has a seven-year term and Toys Properties is required to repay the loans in part in quarterly installments from the first anniversary date. The final maturity date is April 7, 2013. The credit agreement also contains various and customary events of default with respect to the loans, including, without limitation, the failure to pay interest or principal when the same is due under the credit agreement, cross default provisions, the failure of representations and warranties contained in the Credit Agreement to be true and certain insolvency events with respect to Toys Properties. The Senior Loan bears interest at an annual rate of mandatory costs plus 4.5575% plus a margin ranging from 0.28% to 1.50% and the Junior Loan bears interest at an annual rate of mandatory costs plus LIBOR plus a margin of 2.25%. Toys Properties has entered into hedging arrangements in relation to its floating rate exposure under the credit agreement, whereby Toys Properties effectively fixed the interest under the Junior Loan at 6.8075% plus mandatory costs per annum. The proceeds from the U.K. transactions, together with other available funds, were used to repay all of the outstanding indebtedness under the $1.0 billion European bridge facility component of the Senior Facilities Agreement entered into by Toys R Us (UK) Limited on July 21, 2005 and to pay part of the transaction costs.

$804 Million Secured Term Loan Facility and $200 Million Asset Sale Facility

On July 19, 2006, Toys-Delaware, a subsidiary of Toys R Us, Inc. entered into secured credit facilities with a syndicate of financial institutions (the Secured Credit Facilities). The initial borrowings of $1.004 billion under the Secured Credit Facilities were used to repay in full $973 million of outstanding borrowings under the Bridge Loan Agreement, dated as of July 21, 2005 (the Bridge Loan Agreement), plus accrued and unpaid interest thereon and to pay related expenses. Certain of the lenders under the Secured Credit

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Facilities were also lenders under the Bridge Loan Agreement. The Secured Credit Facilities consist of an $804 million secured term loan facility and a $200 million asset sale facility. The term loan facility matures on July 19, 2012 and the asset sale facility matures on July 19, 2008. The term loan facility bears interest equal to LIBOR plus 4.25% per annum. Concurrently with entering into the new secured term loan facility, we entered into an interest rate swap to effectively fix the interest rate on $600 million of the secured term loan at 9.685% with a termination date of August 19, 2008. In addition, we entered into a forward starting interest rate cap effectively capping the LIBOR rate on $600 million of the secured term loan at 7.50% starting in August 2008 and terminating in August 2010. The asset sale facility bears interest equal to LIBOR plus 3.00% per annum until the three-month anniversary of the closing of the Secured Credit Facilities and LIBOR plus 3.50% per annum from the three-month anniversary of the closing date until the six-month anniversary and from and including the six-month anniversary of the closing date and thereafter LIBOR plus 4.00% per annum. In addition, obligations under the Secured Credit Facilities are guaranteed by substantially all domestic subsidiaries of Toys-Delaware and the borrowings thereunder are secured by accounts receivable, inventory and intellectual property of Toys-Delaware and the guarantors. The Secured Credit Facilities contain customary covenants, including, among other things, covenants that restrict the ability of Toys-Delaware and certain of its subsidiaries to incur certain additional indebtedness, create or permit liens on assets, or engage in mergers or consolidations. If an event of default under the Secured Credit Facilities occurs and is continuing, the commitments thereunder may be terminated and the principal amount outstanding thereunder, together with all accrued unpaid interest and other amounts owed thereunder, may be declared immediately due and payable by the lenders. At October 28, 2006, the unamortized discount recorded for the $804 million secured term loan facility was $4 million.

On October 18, 2006, Toys-Delaware used $156 million from the sale of the properties to repay a portion of the $200 million asset sale facility leaving an outstanding balance of $44 million. In connection with the principal repayment, a pro-rata portion of previously capitalized transaction costs in the amount of approximately $5 million was expensed.

On July 26, 2006, we and our wholly-owned subsidiary, Toys-Delaware, received a letter dated July 25, 2006 from an investment advisor to investors that beneficially hold a portion of our and Toys-Delaware s $200 million aggregate principal amount of 8.75% Debentures due September 1, 2021 (the Debentures) issued under an Indenture dated as of August 29, 1991, as amended by Supplemental Indenture No. 1, dated as of January 1, 1996 (as amended, the Indenture). The letter purported to be a notice of default relating to the Debentures. We informed the trustee under the Indenture that we are not in default under the Indenture. Subsequent to October 28, 2006, Toys-Delaware consummated the Tender Offer and entered into a new $181 million senior unsecured credit facility. In connection with the Tender Offer described in Note 18 entitled Subsequent events , the investment advisor delivered a letter notice withdrawing its purported notice of default letter and waiving any purported default alleged or purported acceleration relating thereto, effective upon Toys-Delaware s acceptance of its tendered Debentures in the Tender Offer. The investment advisor tendered their Debentures in the Tender Offer, and as described in Note 18 entitled Subsequent events, the Tender Offer was consummated on December 1, 2006. Toys-Delaware received tenders from holders of $178 million (approximately 89.2%) of the outstanding Debentures in the Tender Offer and used borrowings under the new senior unsecured credit facility to purchase the tendered Debentures. See Note 18 entitled Subsequent events .

10. Income taxes

The following table summarizes our effective tax rates for the thirteen weeks and thirty-nine weeks ended October 28, 2006, and October 29, 2005:

	13 Weeks Ended		39 Weeks Ended	
(In millions)	**October 28, 2006**	**October 29, 2005**	**October 28, 2006**	**October 29, 2005**
Loss before income taxes	**$ (60)**	$ (194)	**$ (306)**	$ (704)
Income tax benefit	**$ 82**	$ 68	**$ 184**	$ 178
Effective tax rate	**137%**	35%	**60%**	25%

The difference between the effective tax rates and the statutory rate for the thirteen and thirty-nine weeks ended October 28, 2006 resulted primarily from an increase in our estimate of worldwide income for the year, an increase in our estimate of dividends and foreign tax credits from foreign subsidiaries for the year, an increase in reserves for certain tax contingencies and a decrease in certain valuation allowances on deferred tax assets related to foreign net operating loss carryforwards.

During the thirteen weeks ended October 28, 2006 we reversed $80 million of valuation allowance on deferred tax assets related to foreign net operating loss carryforwards for subsidiaries where we have now concluded that it is more likely than not that such net operating loss carryforwards will be utilized and recorded $2 million of foreign tax credits. The tax benefits were offset in part by $16 million of reserves for estimated tax contingencies, $5 million of tax associated with non-deductible transaction costs, and $2 million of tax for certain non-deductible compensation paid to the Company s executives.

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During the thirteen weeks ended October 29, 2005, we recorded a $20 million benefit related to our Japanese investment, offset in part by taxes of $10 million for certain non-deductible compensation paid to the Company s executives and $4 million for certain merger related costs.

During the thirty-nine weeks ended October 28, 2006, we reversed $86 million of valuation allowance on deferred tax assets related to foreign net operating loss carryforwards for subsidiaries where we have now concluded that it is more likely than not that such net operating loss carryforwards will be utilized and recorded $11 million of foreign tax credits. The tax benefits were offset in part by $9 million of reserves for estimated tax contingencies, $5 million of tax associated with non-deductible transaction costs, and $2 million of tax for certain non-deductible compensation paid to the Company s executives.

During the thirty-nine weeks ended October 29, 2005, we recorded tax charges of $46 million related to our Japanese investment, $50 million for previously unrepatriated earnings, $44 million for non-deductible transaction costs, $14 million for the reversal of tax assets for expiring state net operating losses, and $10 million for certain non-deductible compensation paid to the Company s executives. The tax impact was offset in part by tax benefits of $39 million associated with section 965 technical clarification, $30 million for reversal of valuation allowance on deferred tax assets related to state net operating loss carryforwards, and a $9 million reduction in reserves for certain tax contingencies.

11. Stock-Based compensation

Adoption of FASB Statement No. 123(R), Share-Based Payment

Effective January 29, 2006, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 123(R) (revised 2004), Share-Based Payment (SFAS 123(R)). Under the provisions of SFAS 123(R), stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense over the requisite service period. As the Company was a nonpublic entity, at the date of adoption, that used the minimum value method for pro forma disclosures under SFAS No. 123, Accounting for Stock-Based Compensation (SFAS 123), the Company is required to apply the prospective transition method. As such, the Company applies the statement to any new awards and to any awards modified, repurchased or cancelled since January 29, 2006. The Company has continued to account for any portion of awards outstanding at January 28, 2006 that has not been modified, repurchased or cancelled using the provisions of Accounting Principles Board Opinion (APB) 25 . In addition, the Company has discontinued pro forma disclosures previously required by SFAS 123 for equity share options accounted for using the intrinsic value method of APB 25.

During the thirty-nine weeks of fiscal 2006, the Company issued equity awards to certain employees and modified certain awards that were granted prior to the adoption of SFAS 123(R). The modified awards are accounted under the provisions of SFAS 123(R). The effect of the adoption of SFAS 123(R) on the Company s loss before income tax and net income (loss) for the thirteen weeks and thirty-nine weeks ended October 28, 2006 was as follows (in millions):

	13 Weeks Ended October 28, 2006			39 Weeks Ended October 28, 2006		
(In millions)	**Using Previous Method**	**FAS 123 (R) Impact**	**As Reported**	**Using Previous Method**	**FAS 123 (R) Impact**	**As Reported**
Loss before income taxes and minority interest	$ (59)	$ (1)	**$ (60)**	$ (304)	$ (2)	**$ (306)**
Net income (loss)	$ 30	$ (1)	**$ 29**	$ (112)	$ (2)	**$ (114)**

SFAS 123(R) requires cash flows, if any, resulting from the tax benefits from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as financing cash flows. Adoption of SFAS 123(R) did not have a material impact on our operating and financing cash flows because the Company did not have any material windfall tax benefits in the period of adoption.

Management Equity Plan

On July 21, 2005, the Board of Directors of Toys R Us Holdings, Inc. (Holdings) adopted the 2005 Management Equity Plan (2005 Plan). The 2005 Plan provides for the granting of service-based and performance-based stock options, rollover options (i.e., options in Holdings in lieu of options held prior to the Merger), and restricted stock to officers and other key employees of Holdings and its subsidiaries. All awards are in the form of one or more common strips. Each common strip consists of nine shares of Class A common stock of Holdings and one share of Class L common stock of Holdings.

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The service-based options generally cliff vest 40% on the second anniversary of the award with the remaining portion vesting ratably over the subsequent three years, subject to the participant s continued employment with the Company, and vest automatically upon a change of control of Holdings. The performance-based options will vest in the same manner as the service-based options but only if certain performance targets are achieved based on a specified internal rate of return realized by the Sponsors and the sale multiple realized by the Sponsors. The performance-based options will vest on the eighth anniversary of the date of grant regardless of performance, subject to the participant s continued employment with the Company. All options expire on the tenth anniversary of the date of the grant.

At October 28, 2006, an aggregate of 505,143 strips were reserved for future option grants under the 2005 plan. All outstanding options expire at dates ranging from September 8, 2008 to October 27, 2016. The Board of Directors of Holdings has discretion over the amount of shares available for future issuances of restricted stock and options. Holdings expects to satisfy future exercises from newly issued shares.

Repurchase Obligations

Certain officers of the Company have the right to require Holdings to repurchase the shares that the officer acquired upon the exercise of certain options, the shares issued or issuable upon exercise of rollover options or the shares issued to the officer in the form of restricted stock. The put rights are triggered by the officer s death, disability or by the officer s retirement at any time. The put rights will expire upon either a change in control of Holdings or an initial public offering of Holdings common stock. The purchase price for shares repurchased as a result of the officer s death or disability or retirement is the fair market value of the covered shares at the time of repurchase. The number of shares that may be repurchased as a result of the officer s retirement is subject to an aggregate fixed limitation. The liability as of the Merger date of $4 million related to these restricted shares and rollover options has been classified as other non-current liabilities in the financial statements of Holdings. The liability as of January 28, 2006 and October 28, 2006 was $4 million and $2 million, respectively.

Modification of Stock Options

On February 6, 2006, Holdings Board of Directors modified all of the performance-based options granted prior to that date to reduce the performance conditions for vesting of these awards. This one-time modification resulted in total incremental stock-based compensation cost of $1 million. These performance-based options are now subject to SFAS 123(R) accounting. The incremental compensation cost will be amortized over the remaining service period on a straight-line basis. This modification did not have a material effect on our operating results for the thirteen and thirty-nine weeks ended October 28, 2006.

Restricted stock

The 2005 Plan permits the sale of non-transferable, restricted stock to certain employees at a purchase price equal to fair market value of the common strips. The 2005 Plan was amended in the second quarter of 2006 to permit grants of restricted stock without consideration. On January 28, 2006, 62,805 common strips of restricted stock were purchased by officers of the Company at $26.75 per common strip, the fair market value as of that date. During the thirty-nine weeks ended October 28, 2006, 118,692 common strips of restricted stock were purchased by officers of the Company at $26.75 per common strip, which was the fair market value as of the respective dates of those purchases. 41,121 common strips of restricted stock were awarded in the second quarter of 2006 with an aggregate fair market value equal to $1 million as of the grant date. This restricted stock award will vest as to 50% of the common strips on the first anniversary of the grant date and as to 50% of the common strips on the second anniversary of the grant date provided the recipients are still employed by the Company or any of its affiliates as of such respective dates. The impact of this restricted stock award on our operating results was immaterial for the thirteen and thirty-nine weeks ended October 28, 2006.

Valuation Assumptions

The fair value of each option award modified or granted during the thirty-nine weeks ended October 28, 2006 is estimated on the date of modification or grant using a lattice option-pricing model that uses the assumptions noted in the following table, along with the associated weighted average fair values. We use historical data to estimate pre-vesting option forfeitures. To the extent actual results of forfeitures differ from the estimates, such amounts will be recorded as an adjustment in the period the estimates are revised. The expected volatilities are based on a peer group of companies, as the Company is a non-publicly traded company. The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant for periods corresponding with the expected life of the options. The expected term represents the estimated time until exercise and is based on certain projected performance targets of the Company. The expected dividend yield is based on an assumption that no dividends are expected to be approved in the near future. The option valuation model also includes a fixed assumption relative to the expected exit date of the Sponsors. The following are the weighted average assumptions used:

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	39 Weeks Ended October 28, 2006
Volatility	50.0%
Risk-free interest rates	4.6%
Expected terms	5.4 years
Dividend Yield	0.0%
Weighted average grant-date fair value per option:	
Service-based	$ 12.03
Performance-based	$ 10.41

A summary of option activity under the plans during the thirty-nine weeks ended October 28, 2006 is presented below:

Service-Based Options

	Options	Weighted Average Exercise Price $	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value (In millions)
Outstanding at January 28, 2006	1,521,732	19.03		
Granted	465,747	26.75		
Exercised	(97,245)	8.83		
Forfeited	(138,063)	26.75		
Outstanding at October 28, 2006	1,752,171	21.04	8.01	10.0
Vested or expected to vest at October 28, 2006	1,668,876	20.75	7.93	10.0
Exercisable at October 28, 2006	610,623	10.36	6.10	10.0

The total intrinsic value of service-based options exercised in the thirty-nine weeks ended October 28, 2006 was $1.7 million. Net cash paid in the thirty-nine weeks ended October 28, 2006 to settle stock repurchased on exercise of options was $1.7 million.

Performance-Based Options

	Options	Weighted Average Exercise Price ($)	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value (In millions)
Outstanding at January 28, 2006	1,545,822	26.75		
Granted	931,495	26.75		
Exercised				
Forfeited	(276,126)	26.75		
Outstanding at October 28, 2006	2,201,191	26.75	9.05	
Vested or expected to vest at October 28, 2006	1,705,865	26.75	8.92	
Exercisable at October 28, 2006				

There were no performance-based options exercised during the thirty-nine weeks ended October 28, 2006.

Non-vested Restricted Stock Activity Non-vested restricted stock grants as of October 28, 2006 and activities during the thirty-nine weeks ended October 28, 2006 were as follows:

	Common Strips	Weighted Average Grant Date Fair Value (In millions)
Outstanding at January 28, 2006		$
Granted	41,121	1
Forfeited		
Outstanding at October 28, 2006	41,121	$ 1

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As of October 28, 2006, there was $10 million of total unrecognized compensation cost related to option share-based compensation arrangements granted under the plan. That cost is expected to be recognized over a weighted-average period of 2.6 years. In addition, there was $1 million of total unrecognized compensation cost related to restricted stock grants.

Stock-based compensation expense was included in the following categories of our statement of operations (in millions):

(In millions)	13 Weeks Ended October 28, 2006	39 Weeks Ended October 28, 2006
Selling, general and administrative	**$ 1**	**$ 3**
Total recognized tax benefit		

Toys Japan stock plan

Our 47.9% owned subsidiary, Toys-Japan, a public entity listed in Japan, adopted SFAS 123(R) using the modified prospective method allowed for public companies. Under the modified prospective method, SFAS 123(R) is applied to all options granted after adoption and unvested portion of any awards granted prior to adoption of SFAS 123(R). The impact of adoption was not material.

Toys-Japan grants options to its employees and directors that give the option holders the right to buy Toys-Japan shares upon exercise. The options are granted at an exercise price equal to the fair value of the shares on the date of the grant and cliff vests after two years and the options expire three years after vesting. At October 28, 2006, 1,028,700 options were outstanding, which represented less than 3% of Toys-Japan s equity on a fully diluted basis.

12. Comprehensive income (loss)

Comprehensive income (loss), net of taxes, is comprised of:

	13 Weeks Ended		39 Weeks Ended	
(In millions)	October 28, 2006	October 29, 2005	October 28, 2006	October 29, 2005
Net income (loss)	**$ 29**	$ (126)	**$ (114)**	$ (526)
Foreign currency translation adjustments	**(16)**	(1)	**(36)**	(48)
Unrealized loss on hedged transactions net of tax	**(5)**	(3)	**(7)**	6
Minimum pension liability adjustment net of tax				1
Comprehensive income (loss):	**$ 8**	$ (130)	**$ (157)**	$ (567)

13. Segments

Our reportable segments are: Toys R Us-U.S., which operates toy stores in 49 states and Puerto Rico; Toys R Us-International, which operates and licenses or franchises toy stores in 32 foreign countries; and Babies R Us, which operates stores in 41 states.

During the third quarter of fiscal 2006, we reorganized our operations, resulting in Toysrus.com being reflected as part of our Toys R Us - U.S. segment. This change results from the reorganization to forge an increasingly seamless integration of the Toysrus.com business with the Toys R Us - U.S. business and was made feasible by the termination of our strategic alliance agreement with Amazon.com, as well as to reduce overlaps in our assessment of operational performance and the resulting allocation of resources. Our chief operating decision maker no longer reviews the operating results of the Toysrus.com business on a stand alone basis, but rather makes decisions regarding the allocation of resources to this business as part of his assessment of the total Toys R Us - U.S. operating results and business. Prior year information has been restated to reflect the current segment structure.

Management evaluates segment performance primarily based on sales and income from operations. 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.

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A summary of operations by reportable segment is as follows:

(In millions)	13 Weeks Ended October 28, 2006	13 Weeks Ended October 29, 2005	39 Weeks Ended October 28, 2006	39 Weeks Ended October 29, 2005
Net sales				
Toys R Us U.S[1]	**$ 981**	$ 1,103	**$ 2,964**	$ 3,320
Toys R Us International[2]	**939**	533	**2,604**	1,502
Babies R Us	**597**	521	**1,751**	1,566
Total net sales	**$ 2,517**	$ 2,157	**$ 7,319**	$ 6,388
Operating earnings (loss)				
Toys R Us U.S[1]	**$ (54)**	$ (130)	**$ (63)**	$ (182)
Toys R Us International[3]	**(6)**	14	**(18)**	(18)
Babies R Us	**87**	60	**243**	175
Corporate and other charges	**(60)**	(16)	**(189)**	(464)
Net gains on sales of properties	**109**		**109**	
Restructuring reversals (charges) and other	**1**	1	**(4)**	(4)
Loss on early extinguishment of debt and contract settlement fees				(22)
Operating earnings (loss)	**77**	(71)	**78**	(515)
Interest expense	**(141)**	(125)	**(401)**	(211)
Interest income	**4**	2	**17**	22
Loss before income taxes and minority interest	**$ (60)**	$ (194)	**$ (306)**	$ (704)

[1] Prior year s information has been restated to reflect the current year segment change and includes Toysrus.com.

[2] Includes net sales of $342 million and $1,018 million related to the consolidation of Toys-Japan for the thirteen weeks and thirty-nine weeks ended October 28, 2006, respectively.

[3] Includes $23 million and $36 million of operating loss related to the consolidation of Toys-Japan for the thirteen weeks and thirty-nine weeks ended October 28, 2006, respectively. For the thirteen weeks and thirty-nine weeks ended October 29, 2005, we reclassified $3 million and $12 million, respectively, of our equity loss in Toys-Japan from corporate and other charges to Toys R Us International.

Certain corporate and other charges are reported separately within our disclosure of segment operating earnings (loss). These expenses include corporate office expenses and shared service center expenses, as well as certain other centrally managed expenses, which are not fully allocated to our reportable segments. The significant categories of expenses include salaries, benefits and related expenses, professional fees, corporate facility depreciation and amortization and insurance. Salaries, benefits and related expenses include salaries, bonus, payroll taxes and medical and dental insurance expenses for corporate office employees. Professional fees include costs related to the internal control compliance, financial statement audits, legal, information technology and other consulting fees, which are engaged and managed through the corporate office. Depreciation and amortization includes depreciation of leasehold improvements for properties occupied by corporate office employees. Corporate insurance expense includes the cost for fire, liability and automobile premiums.

During fiscal 2005, the majority of these expenses were allocated to each of our operating divisions. For fiscal 2006, the Company is no longer allocating these expenses, as management believes that operating results excluding corporate expense allocations provides a better measure of divisional performance. A summary of the corporate expense allocation for the thirteen and thirty-nine weeks ended October 29, 2005 included in operating earnings (loss) by reportable segment is as follows (in millions):

Corporate expense allocation	13 weeks ended October 29,	39 weeks ended October 29,

	2005	2005
Toys R Us U.S.	$ 27	$ 79
Babies R Us	6	18
Toys R Us International	1	3
Total corporate expense allocation	$ 34	$ 100

14. Commitments

On May 9, 2006, we entered into an agreement with GSI Commerce, Inc. (NASDAQ: GSIC), a leading North American provider of e-commerce solutions, and on May 19, 2006, we entered into an agreement with Exel, Inc., a leading North American contract

logistics provider, to support the Company s online retail business. On July 1, 2006, the Company re-launched its Toysrus.com and Babiesrus.com web sites on the GSI e-commerce platform and began utilizing Exel s order fulfillment services. Under the terms of the multi-year agreements, GSI Commerce will provide technology, hosting, order processing, customer service and support in exchange for fees calculated primarily as a percentage of revenue, and Exel will provide warehousing and fulfillment services in exchange for fees calculated primarily as a cost plus arrangement. Customers may continue to access the online stores at www.toysrus.com and www.babiesrus.com.

15. Litigation and legal proceedings

We are involved in lawsuits, claims and proceedings incident to the ordinary course of business. The results of litigation are inherently unpredictable. Any claims against us, whether meritorious or not, could be time consuming, resulting in costly litigation, require significant amounts of management time and result in diversion of significant resources. The results of these lawsuits, claims and proceedings cannot be predicted with certainty. However, we believe that the ultimate resolution of these current matters will not have a material adverse effect on our financial statements taken as a whole.

As of the end of the Company s fiscal 2005 year, Toysrus.com operated three co-branded on-line stores under a strategic alliance agreement with Amazon.com. On May 21, 2004, we filed a lawsuit against Amazon.com and its affiliated companies in the Superior Court of New Jersey, Chancery Division, Passaic County (the New Jersey Trial Court) to terminate our strategic alliance agreement with Amazon.com. On June 25, 2004, Amazon.com filed a counterclaim against us and our affiliated companies alleging breach of contract relating to inventory and selection requirements. On March 31, 2006, the New Jersey Trial Court entered its order granting our request for termination of the agreement and denying Amazon.com s request for relief on its counterclaim. The New Jersey Trial Court continues to supervise the wind-down of the strategic alliance. Amazon.com s efforts to take an immediate appeal were denied by the New Jersey Appellate Court.

On June 2, 2006, Amazon.com filed a lawsuit against us in the Superior Court of Washington, County of King, (the Washington Court) for money damages allegedly arising from services it was required to provide to us during the wind-down period pursuant to the final order entered in the New Jersey Trial Court, and for a declaration that Amazon.com may use certain customer information to market to our customers in a manner contrary to that provided in the strategic alliance agreement. The Washington Court stayed proceedings before it in favor of the New Jersey Trial Court, and the New Jersey Trial Court has ruled that Amazon.com is not entitled to the fees it sought for services it was required to provide during the wind-down period. On August 14, 2006, the New Jersey Trial Court directed Amazon.com to deliver the withheld monies forthwith and, subsequently, Amazon.com returned the funds. The Washington Court has directed that any further litigation over these issues proceed in the New Jersey courts. We believe that Amazon.com s maintenance of the Washington Court lawsuit is without merit.

16. Related party transactions

Transactions with the Sponsors The Sponsors provide management and advisory services to us pursuant to an advisory agreement. The fee was $4 million for the thirteen weeks ended October 28, 2006 and $15 million for the thirty-nine weeks ended October 28, 2006. The fee w