TOYS R US INC
Form S-1/A
October 01, 2010
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As filed with the Securities and Exchange Commission on October 1, 2010

Registration No. 333-167172

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

AMENDMENT NO. 3

TO

FORM S-1

REGISTRATION STATEMENT

UNDER

THE SECURITIES ACT OF 1933

TOYS R US, INC.

(Exact name of registrant as specified in its charter)

Delaware	**5945**	**22-3260693**
(State or other jurisdiction of incorporation or organization)	**(Primary Standard Industrial Classification Code Number)**	**(I.R.S. Employer Identification Number)**

One Geoffrey Way

Wayne, New Jersey 07470

(973) 617-3500

(Address, including zip code, and telephone number, including area code, of registrant s principal executive offices)

David J. Schwartz, Esq.

Executive Vice President and General Counsel

Toys R Us, Inc.

One Geoffrey Way

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(973) 617-3500

(Name, address, including zip code, and telephone number, including area code, of agent for service)

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Approximate date of commencement of proposed sale to the public: As soon as practicable after this Registration Statement is declared effective.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box. ¨

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

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

Accelerated filer ¨
Smaller reporting company ¨

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to be Registered	**Proposed Maximum Aggregate Offering Price(1)(2)**	**Amount of Registration Fee(3)**
Common Stock, par value $0.001 per share	$800,000,000	$57,040

(1) Includes shares of common stock that the underwriters have an option to purchase. See Underwriting.
(2) Estimated solely for the purpose of calculating the amount of the registration fee pursuant to Rule 457(o) under the Securities Act of 1933, as amended.
(3) Previously paid.

The registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933, as amended, or until the Registration Statement shall become effective on such date as the Securities and Exchange Commission, acting pursuant to said Section 8(a), may determine.

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The information in this preliminary prospectus is not complete and may be changed. These securities may not be sold until the registration statement filed with the Securities and Exchange Commission is effective. This preliminary prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any jurisdiction where the offer or sale is not permitted.

Subject to Completion. Dated October 1, 2010.

Shares

TOYS R US, INC.

Common Stock

This is an initial public offering of the common stock of Toys R Us, Inc.

Since July 2005 and prior to this offering, there has been no public market for our common stock. It is currently estimated that the initial public offering price per share will be between $ and $. Toys R Us, Inc. intends to list the common stock on the New York Stock Exchange under the symbol TOYS.

See Risk Factors beginning on page 13 of this prospectus to read about factors you should consider before buying shares of the common stock.

Neither the Securities and Exchange Commission nor any other regulatory body has approved or disapproved of these securities or passed upon the accuracy or adequacy of this prospectus. Any representation to the contrary is a criminal offense.

	Per Share	Total
Initial public offering price	$	$
Underwriting discount	$	$
Proceeds, before expenses, to us	$	$

To the extent that the underwriters sell more than shares of common stock, the underwriters have the option to purchase up to an additional shares from us at the initial offering price less the underwriting discount.

The underwriters expect to deliver the shares against payment in New York, New York on or about , 2010.

Joint Book-Running Managers

Goldman, Sachs & Co. **J.P. Morgan** **BofA Merrill Lynch** **Credit Suisse**

Deutsche Bank Securities **Citi** **Wells Fargo Securities**

Co-Managers

Needham & Company, LLC **Mizuho Securities USA Inc.**

BMO Capital Markets **Daiwa Capital Markets**

Prospectus dated , 2010.

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You should rely only on the information contained in this prospectus or in any free writing prospectus that we authorize be delivered to you. Neither we nor the underwriters have authorized anyone to provide you with additional or different information. If anyone provides you with additional, different or inconsistent information, you should not rely on it. We and the underwriters are not making an offer to sell these securities in any jurisdiction where an offer or sale is not permitted. You should assume that the information in this prospectus is accurate only as of the date on the front cover, regardless of the time of delivery of this prospectus or of any sale of our common stock. Our business, prospects, financial condition and results of operations may have changed since that date.

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Through and including , 2010 (the 25th day after the date of this prospectus), all dealers effecting transactions in these securities, whether or not participating in this offering, may be required to deliver a prospectus. This is in addition to a dealer s obligation to deliver a prospectus when acting as an underwriter and with respect to an unsold allotment or subscription.

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PROSPECTUS SUMMARY

This summary highlights significant aspects of our business and this offering, but it is not complete and does not contain all of the information that you should consider before making your investment decision. You should carefully read the entire prospectus, including the information presented under the section entitled Risk Factors and the historical financial and other data and related notes, before making an investment decision. Unless otherwise indicated, all information contained in this prospectus concerning the toys and juvenile product industry in general, including information regarding our leading position and market share within our industry, is based on management s estimates using internal data, data from industry trade groups, consumer record and marketing studies and other externally obtained data. This summary contains forward-looking statements that involve risks and uncertainties. Our actual results may differ significantly from the results discussed in the forward-looking statements as a result of certain factors, including those set forth in Risk Factors and Forward Looking Statements. As used herein, references to the Company, we, us, our, and, where applicable, Toys R Us are to Toys R Us, Inc., the issuer of the common stock, a Delaware corporation, and its subsidiaries.

We use a 52-53 week fiscal year ending on the Saturday nearest to January 31. Unless otherwise stated, in this prospectus, references to fiscal 2009 refer to the fiscal year ended January 30, 2010 (consisting of 52 weeks); references to fiscal 2008 refer to the fiscal year ended January 31, 2009 (consisting of 52 weeks); and references to fiscal 2007 are to the fiscal year ended February 2, 2008 (consisting of 52 weeks).

We refer to Adjusted EBITDA in this prospectus summary and elsewhere in this prospectus. For the definition of Adjusted EBITDA, an explanation of why we present it and a description of the limitations of this non-GAAP measure, as well as a reconciliation to net earnings, see Summary Historical Financial and Other Data.

Our Company

We are the leading global specialty retailer of toys and juvenile products as measured by net sales. For over 50 years, Toys R Us has been recognized as the toy and baby authority. In the U.S., in fiscal 2009, approximately 70% of households with kids under 12 shopped at our Toys R Us stores, and 84% of first time mothers shopped at our Babies R Us stores according to a survey by Leo J. Shapiro & Associates, LLC. We believe we offer the most comprehensive year-round selection of toys and juvenile products, including a broad assortment of private label and exclusive merchandise unique to our stores.

As of July 31, 2010, we operated 1,363 stores and licensed an additional 211 stores. These stores are located in 34 countries and jurisdictions around the world under the Toys R Us, Babies R Us and FAO Schwarz banners. In addition to these stores, during the fiscal 2009 holiday season, we opened 91 Toys R Us Holiday Express stores (pop-up stores), a temporary store format located in high-traffic shopping areas, 28 of which remained open as of July 31, 2010. We expect to open a total of approximately 600 pop-up stores in the upcoming holiday season. As of September 24, 2010, we had opened 418 pop-up stores. We also sell merchandise through our websites at Toysrus.com, Babiesrus.com, eToys.com, FAO.com and babyuniverse.com. For fiscal 2009, we generated net sales of $13.6 billion, net earnings of $312 million and Adjusted EBITDA of $1,130 million.

We operate in an attractive industry that has proven to be resilient due to the demand for toys (including video games and video game systems) and juvenile (including baby) products, driven by the desire of families to spend on their children and by population growth.

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Our History

Our Company was founded in 1948 when Charles Lazarus opened a baby furniture store, Children s Bargain Town, in Washington, D.C. The Toys R Us name made its debut in 1957. In 1978, we completed an initial public offering of our common stock. When Charles Lazarus retired as our Chief Executive Officer in 1994, the Company operated or licensed over 1,000 stores in 17 countries and jurisdictions. In 1996, we established the Babies R Us brand, further solidifying our reputation as a leading consumer destination for children and their families.

On July 21, 2005, we were acquired by an investment group led by entities advised by or affiliated with Bain Capital Partners, LLC, Kohlberg Kravis Roberts & Co. L.P., and Vornado Realty Trust. We refer to this collective ownership group as our Sponsors . Upon the completion of this acquisition, we became a private company.

Progress Since Our 2005 Acquisition

Strengthening our management team was our top priority following the 2005 acquisition. The rebuilding effort began with the hiring of Gerald L. Storch, our Chairman and Chief Executive Officer, who joined the Company in February 2006 from Target Corporation, where he was most recently Vice Chairman. He assembled the Company s leadership team, recruiting seasoned executives with significant retail experience.

Our new management team has made significant improvements to the business, producing strong results to date and laying the foundation for continued improvement. Over the past five years, we achieved the following:

Streamlined the organizational structure of the Company. We harnessed the collective strength of the Toys R Us and Babies R Us brands by combining their respective corporate, merchandising and field operation functions. In addition, we established a common global culture for our business and refined our capital management processes.

Developed and launched our juvenile integration strategy. We designed and implemented new integrated store formats that combine the Toys R Us and Babies R Us brands and merchandise offerings under one roof, providing a one stop shopping environment for our guests. These formats are side-by-side stores and R Superstores. Side-by-side stores are a combination of Toys R Us and Babies R Us stores. Our R Superstores are conceptually similar to side-by-side stores, except that they are larger in size. Either format may be the result of a conversion or relocation and, in certain cases, may be accompanied by the closure of one or more existing stores. In addition, side-by-side stores and R Superstores may also be constructed in a new location and market.

These integrated formats have become powerful vehicles for remodeling and updating our existing store base, generating significant improvements in store-level net sales and profitability. For example, in the first 12 months after conversion, without any increase in square footage, the aggregate store sales for our 53 domestic and 52 of our international side-by-side stores converted during fiscal years 2006, 2007 and 2008, increased, on a weighted average basis (based on net sales) by 20% and 13%, respectively, as compared to the 12 month period prior to commencement of construction for the conversion. The aggregate store sales increases described above are reduced by our estimate of net sales that were transferred from existing stores (generally Babies R Us standalone stores) in the vicinity to the new converted stores.

Improved the shopping experience for our guests. In the U.S., from 2005 to 2009, Toys R Us and Babies R Us guest service scores increased by 9% and 5%, respectively.

Focused on optimizing our store portfolio. As of July 31, 2010, we have opened 107 Company operated stores, closed 113 Company operated stores and converted or relocated 173 Company operated stores to our integrated store format since the end of fiscal 2005. In addition, the number of licensed stores increased from 173 to 211 during the same time period. In fiscal 2009, 98% of our operated stores were store-level EBITDA positive.

Grew our on-line business. In 2006, we began selling through our Toysrus.com and Babiesrus.com websites. Through our business initiatives and acquisitions, we have expanded our on-line business from $486 million in net sales in fiscal 2005 to $602 million in net sales in fiscal 2009.

These initiatives, along with other operating improvements, have delivered strong financial results, with Adjusted EBITDA growing by 55% from fiscal 2005 to fiscal 2009.

Our Competitive Strengths

We believe that the following key competitive strengths differentiate our business:

We are the leading specialty retailer of toys and juvenile products. We have brand names that are highly recognized around the world and strong relationships with our guests and vendors. We also believe our focus on quality of products, service and safety is a competitive strength.

Highly recognized brand names. In the U.S., Toys R Us and Babies R Us maintain a 98% and 86% brand awareness, respectively, among adults over 18-years-old according to a market study conducted by Marketing Evaluations, Inc. in 2009.

Long-lasting relationships with our guests. Our product assortment allows us to capture new parents as customers during pregnancy, helping them prepare for the arrival of their newborn, and then as new parents and consumers of our toy products. We continue to build on these relationships as these children grow and eventually become parents themselves.

Strong relationships with vendors. Given our market leadership position, we have been able to develop strategic partnerships with many of our vendors and provide them with a year-round platform for their brand and testing of products.

Broad and deep product assortment. Our broad and deep product assortment, which we believe offers our guests the most comprehensive year-round selection of toys and juvenile products, enables us to command a reputation as the shopping destination for toys and juvenile products.

We have a global footprint and multi-channel distribution capabilities. We have a global presence and reach children and their families in 34 countries and jurisdictions around the world.

Global footprint. We are one of the few hardline specialty retailers with a global footprint, based on a review of other hardline specialty retailers, with 39% of our consolidated net sales and 43% of our total operating earnings, excluding unallocated corporate selling, general & administrative expenses, generated outside the U.S. in fiscal 2009. We believe that operating as a global and geographically diverse company enhances our ability to identify trends, test new products and the stability of our business by exposing us to growth opportunities in different markets and across a broad customer base.

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Multiple retail store formats. We operate a variety of store formats, which enable us to reach our customers in many different ways. Our big box formats include standalone Toys R Us stores, standalone Babies R Us stores and integrated formats which combine our Toys R Us and Babies R Us merchandise offerings under one roof. In addition to these formats, we have recently tested 91 pop-up stores that enabled us to reach more customers during the holiday season.

Differentiated real estate strategy with attractive underlying portfolio. We own stores on land we own and on properties we long-term ground lease located in eight countries, representing approximately 47% of our entire store base as of July 31, 2010. The significant ownership level of our real estate, as well as the ongoing effective management of our leases, provides substantial flexibility to execute our juvenile integration strategy in a capital-efficient manner.

Leading on-line position. We also sell merchandise through our Internet sites Toysrus.com and Babiesrus.com, as well as our newly acquired eToys.com, FAO.com and babyuniverse.com Internet sites.

We have significant experience in managing the seasonal nature of our business. From warehousing and distribution, to hiring and training a seasonal workforce and promotional planning, we have invested in the technology and infrastructure to handle the increased demand during the holiday season in a cost effective manner.

We have an experienced management team with a proven track record. Our senior management team has an average of approximately 20 years of retail experience across a broad range of disciplines in the specialty retail industry, including merchandising, finance and real estate.

Our Growth Strategy

We intend to strengthen our position in the marketplace, increase revenues and grow profits primarily through the following initiatives:

Continue juvenile integration strategy across the existing store base. Converting or relocating our standalone Toys R Us stores into our side-by-side and our R Superstore formats has generated significant improvements in our comparable store net sales and store-level profitability. With only 11% of our global stores (or 152 stores) having been converted or relocated to an integrated format through the end of fiscal 2009, we believe, based on our review of the markets where our stores are located, we have the potential to convert or relocate another 60% to 70% of our standalone stores globally into our side-by-side and R Superstore formats over the next decade. We expect to convert or relocate 82 stores to our side-by-side or R Superstore formats in fiscal 2010 (of which 25 have been converted or relocated through July 31, 2010) for an estimated cost of approximately $156 million.

Expand our store base. We have the potential to open new stores in existing and new markets both domestically and internationally, virtually all of which will be in the integrated format, either as side-by-side stores or R Superstores. We believe we have the potential to increase our retail square footage, net of closures, globally, in excess of 15% over the next several years, through our new store growth and relocations of existing stores to R Superstores. In addition, we expect to open a significant number of pop-up stores in the upcoming holiday season and believe that we have the opportunity to continue this strategy in future years.

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Expand our on-line presence. We plan to further expand our on-line business by continuing to integrate our Internet capabilities with our traditional stores. We are planning to introduce websites in countries where we have physical stores but lack a web presence, as well as enter new international markets where we do not have any physical stores.

Improve sales productivity in our base business. In addition to our juvenile integration strategy, we intend to continue to improve space utilization, in-stock positions and store standards, flex our toys and juvenile products categories seasonally and optimize store hours.

Execute strategies to expand our operating profit margin. We will continue to focus on expanding our gross margins primarily through optimizing pricing, improving vendor allowances, increasing our private label penetration and increasing our use of direct sourcing and manage our selling, general and administrative expenditures.

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Risk Factors

Investing in our common stock involves substantial risk, and our ability to successfully operate our business is subject to numerous competitive risks and challenges, including those that are generally associated with operating in the retail industry. Any of the factors set forth under Risk Factors may limit our ability to successfully execute our business strategy or may adversely affect our revenues and overall profitability. You should carefully consider all of the information set forth in this prospectus and, in particular, should evaluate the specific factors set forth under Risk Factors in deciding whether to invest in our common stock. Among these important risks and challenges are the following:

Competitive risks and challenges related to our business:

- our industry is highly competitive and competitive conditions may adversely affect our revenues and overall profitability;
- we depend on key vendors and our vendors failure to supply quality merchandise in a timely manner may damage our reputation and harm our business;
- our revenues may decline due to general economic weakness or a reduction in consumer spending on toys and juvenile products;
- we may not successfully gauge trends and changing consumer preferences;
- our business is highly seasonal and our financial performance depends on the results of the fourth quarter of each fiscal year;
- we may not successfully implement our plans to continue our juvenile integration strategy, expand our store-base, expand our on-line presence, improve our sales productivity and operating profit margin, broaden our product offerings or expand our sales channels;
- our results of operations are subject to risks arising from the international scope of our operations including fluctuations in foreign currency exchange rates;
- product safety issues, including product recalls, could harm our reputation, divert resources, reduce sales and increase costs;

Risks related to our indebtedness:

- our substantial debt makes us especially vulnerable to adverse trends in general economic and industry conditions;
- our operations have significant liquidity and capital requirements and depend on the availability of adequate financing on reasonable terms;
- our debt agreements contain restrictions that limit our flexibility in operating our business;

Risks related to our common stock:

the Sponsors currently own, and will continue to own after the offering, shares sufficient to control our operations and, as a result, your ability to influence the outcome of key transactions may be limited; and

as a controlled company within the meaning of the New York Stock Exchange rules, we will qualify for and intend to rely on exemptions from certain corporate governance requirements and will not have the same protections afforded to shareholders of companies that are subject to such requirements.

Our principal executive offices are located at One Geoffrey Way, Wayne, New Jersey 07470, and our telephone number is (973) 617-3500. Our website address is www.toysrusinc.com. The information on our website is not part of this prospectus.

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The Offering

Common stock offered by Toys R Us, Inc..	shares
Common stock to be outstanding after this offering	shares (shares if the underwriters exercise their option in full)
Use of proceeds	We estimate that the net proceeds to us from this offering, after deducting underwriting discounts and estimated offering expenses, will be approximately $ million, assuming the shares are offered at $ per share, which is the midpoint of the estimated initial public offering price range set forth on the cover page of this prospectus

We intend to use the anticipated net proceeds primarily to repay certain of our existing indebtedness and also for general corporate purposes.

Underwriters option	We have granted the underwriters a 30-day option to purchase up to additional shares of our common stock at the initial offering price
Dividend policy	We have no current plans to pay dividends on our common stock in the foreseeable future
Advisory Agreement fees	Upon the completion of this offering, pursuant to and in connection with the terms of the advisory agreement, we will pay total fees of approximately $111 million to affiliates of the Sponsors and terminate the agreement (which amount will include a transaction fee equal to 1%, or approximately $8 million, of the estimated gross proceeds from this offering, a termination fee equal to approximately $100 million and certain contingent fees equal to approximately $3 million). See Certain Relationships and Related Party Transactions Advisory Agreement
Risk Factors	You should carefully read and consider the information set forth under Risk Factors beginning on page 13 of this prospectus and all other information set forth in this prospectus before investing in our common stock
Proposed NYSE ticker symbol	TOYS

Unless we indicate otherwise or the context requires, all information in this prospectus:

assumes (1) no exercise of the underwriters option to purchase additional shares of our common stock and (2) an initial public offering price of $ per share, the midpoint of the estimated initial public offering range indicated on the cover of this prospectus.

gives effect to the -for-one stock split of our common stock, which will occur prior to the consummation of this offering.

does not reflect (on a pre-split basis) (1) 3,511,031 shares of our common stock issuable upon the exercise of 3,511,031 outstanding stock options held by our officers and employees at a weighted average exercise price of $26.18 per share as of July 31, 2010, 2,530,610 of which shares were then exercisable; (2) 385,112 shares of our common stock reserved for future grants under our Management Equity Plan (the Management Equity Plan), which the Company does not intend to grant after the adoption of the 2010 Incentive Plan, described below; and (3) shares of our common stock reserved for future grants under our Toys R Us, Inc. 2010 Incentive Plan expected to be entered into in connection with this offering (the 2010 Incentive Plan).

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Summary Historical Financial and Other Data

Set forth below is summary historical consolidated financial and other data of Toys R Us, Inc. at the dates and for the periods indicated. We derived the summary historical statement of operations data for the fiscal years ended January 30, 2010, January 31, 2009 and February 2, 2008, and balance sheet data as of January 30, 2010 and January 31, 2009 from our historical audited consolidated financial statements included elsewhere in this prospectus. We derived the summary historical statement of operations data for the fiscal years ended February 3, 2007 and January 28, 2006 and the balance sheet data as of February 2, 2008, February 3, 2007 and January 28, 2006 presented in this table from our consolidated financial statements not included in this prospectus.

We derived the summary condensed consolidated financial data for the twenty-six-week periods ended July 31, 2010 and August 1, 2009 from our unaudited condensed consolidated interim financial statements included elsewhere in this prospectus. Our unaudited condensed consolidated interim financial statements were prepared on a basis consistent with our audited consolidated financial statements. In management s opinion, the unaudited condensed consolidated interim financial statements include all adjustments, consisting of normal recurring accruals, necessary for the fair presentation of those statements.

Our historical results are not necessarily indicative of future operating results and our interim results for the twenty-six weeks ended July 31, 2010 are not projections for the results to be expected for fiscal year ended January 29, 2011. The information set forth below should be read in conjunction with, and is qualified in its entirety by reference to, Selected Historical Financial and Other Data, Management s Discussion and Analysis of Financial Condition and Results of Operations, and our consolidated financial statements, condensed consolidated financial statements and the related notes included elsewhere in this prospectus.

(In millions, except number of stores and share data)	Fiscal Years Ended(1)					26 Weeks Ended	
	January 30, 2010	January 31, 2009	February 2, 2008	February 3, 2007	January 28, 2006	July 31, 2010	August 1, 2009
Statement of Operations Data:							
Net sales	$ 13,568	$ 13,724	$ 13,794	$ 13,050	$ 11,333(2)	$ 5,173	$ 5,044
Cost of sales	8,790	8,976	8,987	8,638	7,652	3,270	3,203
Gross margin	4,778	4,748	4,807	4,412	3,681	1,903	1,841
Selling, general and administrative expenses(3)	3,730	3,856	3,801	3,506	2,986	1,713(4)	1,616
Depreciation and amortization	376	399	394	409	400	192	194
Other (income) expense, net(5)	(112)(6)	(128)(7)	(84)	(152)	437(8)	(29)	(76)
Total operating expenses	3,994	4,127	4,111	3,763	3,823	1,876	1,734
Operating earnings (loss)	784	621	696	649	(142)	27	107
Interest expense	(447)	(419)	(503)	(537)	(394)	(245)	(211)
Interest income	7	16	27	31	31	3	4
Earnings (loss) before income taxes	344	218	220	143	(505)	(215)	(100)
Income tax expense (benefit)	40	7	65	35	(121)	(145)	(85)
Net earnings (loss)	304	211	155	108	(384)	(70)	(15)
Less: Net (loss) earnings attributable to noncontrolling interest	(8)	(7)	2	(1)		(1)	(7)
Net earnings (loss) attributable to Toys R Us, Inc.	$ 312	$ 218	$ 153	$ 109	$ (384)	$ (69)	$ (8)
Share Data:							
Earnings (loss) per common share attributable to Toys R Us, Inc.(9):							
Basic	$	$	$	$	$	$	$
Diluted	$	$	$	$	$	$	$

Weighted average shares used in computing per share amounts(9):
Basic earnings per common share
Diluted earnings per common share

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(In millions, except number of stores and share data)	Fiscal Years Ended(1) January 30, 2010	January 31, 2009	February 2, 2008	February 3, 2007	January 28, 2006	26 Weeks Ended July 31, 2010	August 1, 2009
Statement of Cash Flow:							
Net cash provided by (used in)							
Operating activities	$ 1,014	$ 525	$ 527	$ 411	$ 671	$ (963)	$ (493)
Investing activities	(37)	(259)	(416)	(107)	573	(104)	17
Financing activities	(626)	(223)	(152)	(566)	(1,488)	134	(173)
Balance Sheet Data (end of period):							
Working capital	$ 619	$ 617	$ 685	$ 347	$ 348	$ 660	$ 719
Property and equipment, net	4,084	4,187	4,385	4,333	4,175	4,012	4,181
Total assets	8,577	8,411	8,952	8,295	7,863	8,096	8,172
Long-term debt(10)	5,034(11)	5,447	5,824	5,722	5,540	5,055	5,496
Total stockholders equity (deficit)(12)	117	(152)	(235)	(540)	(723)	39	(105)
Other Financial and Operating Data:							
Number of stores Domestic (at period end)	849	846	845	837	901	848	848
Number of stores International operated (at period end)	514	504	504	488	468	515	510
Total operated stores (at period end)	1,363	1,350	1,349	1,325	1,369	1,363	1,358
Number of stores International Licensed (at period end)	203	209	211	190	173	211	195
Adjusted EBITDA(13)	$ 1,130	$ 990	$ 1,095	$ 982	$ 730	$ 261	$ 264
Capital expenditures	$ 192	$ 395	$ 326	$ 285	$ 285	$ 117	$ 93

(1) Our fiscal year ends on the Saturday nearest to January 31 of each calendar year. With the exception of fiscal 2006, which included 53 weeks, all other fiscal years presented are based on a 52 week period.

(2) Toys Japan was consolidated beginning in fiscal 2006. Toys Japan Net sales of $1.6 billion for fiscal 2005 were not included in our Net sales.

(3) Includes the impact of restructuring and other charges. See Note 10 to our consolidated financial statements entitled Restructuring and Other Charges for further information.

(4) Includes a pre-tax reserve of $17 million for certain legal matters and a $16 million pre-tax non-cash cumulative correction of prior period straight-line lease accounting.

(5) Includes $20 million, $78 million, $17 million and $15 million of pre-tax gift card breakage income in fiscals 2009, 2008, 2007 and 2006, respectively. Also includes $11 million and $12 million of pre-tax gift card dormancy income in fiscals 2006 and 2005, respectively. See Note 1 to our consolidated financial statements entitled Summary of Significant Accounting Policies for further details.

Includes $8 million of pre-tax gift card breakage income for the twenty-six weeks ended July 31, 2010 and August 1, 2009, respectively.

Includes the pre-tax impact of net gains on sales of properties of $6 million, $5 million, $33 million, $110 million and a loss of $3 million in fiscals 2009, 2008, 2007, 2006 and 2005, respectively. See Note 5 to our consolidated financial statements entitled Property and Equipment for further details.

Includes the pre-tax impact of net gains on sales of properties of $4 million and $1 million for the twenty-six weeks ended July 31, 2010 and August 1, 2009, respectively.

Includes pre-tax impairment losses on long-lived assets of $7 million, $33 million, $13 million, $5 million and $22 million in fiscals 2009, 2008, 2007, 2006 and 2005. See Note 1 to our consolidated financial statements entitled Summary of Significant Accounting Policies for further details.

Includes pre-tax impairment losses on long-lived assets of $1 million and $5 million for the twenty-six weeks ended July 31, 2010 and August 1, 2009, respectively.

(6) Includes a $51 million pre-tax gain related to the litigation settlement with Amazon.com (Amazon). See Note 15 to our consolidated financial statements entitled Litigation and Legal Proceedings for further details.

(7) Includes a $39 million pre-tax gain related to the substantial liquidation of the operations of TRU (HK) Limited, our wholly-owned subsidiary. See Note 1 to our consolidated financial statements entitled Summary of Significant Accounting Policies for further details.

(8) Includes $410 million of transaction and related costs and $22 million of contract settlement and other fees related to the 2005 acquisition.

(9) All share and per share amounts reflect a -for-one stock split of our common stock, which will occur prior to the consummation of this offering.

(10) Excludes current portion of long-term debt.

(11) Includes the impact of the issuance of $950 million and $725 million of debt on July 9, 2009 and November 20, 2009, respectively, the proceeds from which were used, together with other funds, to repay the outstanding loan balance of $1,267 million and $800 million plus accrued interest and fees. See Note 2 to our consolidated financial statements entitled Long-Term Debt for further details.

(12) On February 1, 2009, we adopted the amendment to ASC Topic 810, Consolidation (ASC 810). The amendment requires a company to clearly identify and present ownership interest in subsidiaries held by parties other than the company in the consolidated financial statements within the equity section but separate from the company s equity. Therefore, we have included our noncontrolling interest in Toys Japan within the Total stockholders equity (deficit) line item.

(13) Adjusted EBITDA is defined as EBITDA (earnings (loss) before net interest income (expense), income tax expense (benefit), depreciation and amortization), as further adjusted to exclude the effects of certain income and expense items that management believes make it more difficult to assess the Company s actual operating performance. Although the nature of many of these income and expense items is recurring, we have historically excluded such impact from internal performance assessments. We believe that excluding items such as sponsors management and advisory fees, asset impairment charges, restructuring charges, impact of litigation, non-controlling interest, gain (loss) on sale of properties, gift card breakage accounting change and the other charges specified below, helps investors compare our operating performance with our results in prior periods. We believe it is appropriate to exclude these items as they are not related to ongoing operating performance and, therefore, limit comparability between periods and between us and similar companies.

We believe Adjusted EBITDA is useful to investors because it is frequently used by securities analysts, investors and other interested parties in the evaluation of companies in our industry. Investors of the Company regularly request Adjusted EBITDA as a supplemental analytical measure to, and in conjunction with, the Company s GAAP financial data. We understand that these investors use Adjusted EBITDA, among other things, to assess our period-to-period operating performance and to gain insight into the manner in which management analyzes operating performance.

In addition, we believe that Adjusted EBITDA is useful in evaluating our operating performance compared to that of other companies in our industry because the calculation of EBITDA and Adjusted EBITDA generally eliminates the effects of financing and income taxes and the accounting effects of capital spending and acquisitions, which items may vary for different companies for reasons unrelated to overall operating performance. We use these non-GAAP financial measures for planning and forecasting and measuring results against the forecast and in certain cases we use similar measures for bonus targets for certain of our employees. Using several measures to evaluate the business allows us and investors to assess our relative performance against our competitors and ultimately monitor our capacity to generate returns for our stockholders.

Although we believe that Adjusted EBITDA can make an evaluation of our operating performance more consistent because it removes items that do not reflect our core operations, other companies, even in the same industry, may define Adjusted EBITDA differently than we do. As a result, it may be difficult to use Adjusted EBITDA or similarly named non-GAAP measures that other companies may use to compare the performance of those companies to our performance. The Company does not, and investors should not, place undue reliance on EBITDA or Adjusted EBITDA as measures of operating performance.

Reconciliation of Net earnings (loss) attributable to Toys R Us, Inc. to EBITDA and Adjusted EBITDA is as follows:

	Fiscal Years Ended					26 Weeks Ended	
(In millions)	**January 30, 2010**	**January 31, 2009**	**February 2, 2008**	**February 3, 2007**	**January 28, 2006**	**July 31, 2010**	**August 1, 2009**
Net earnings (loss) attributable to Toys R Us, Inc.	$ 312	$ 218	$ 153	$ 109	$ (384)	$ (69)	$ (8)
Add:							
Income tax expense (benefit)	40	7	65	35	(121)	(145)	(85)
Interest expense, net	440	403	476	506	363	242	207
Depreciation and amortization	376	399	394	409	400	192	194
EBITDA	1,168	1,027	1,088	1,059	258	220	308
Adjustments:							
Legal reserve(a)						17	
Prior period lease accounting(b)						16	
Sponsors management and advisory fees(c)	15	18	18	20	4	10	8
Impairment on long-lived assets(d)	7	33	13	5	22	1	5
Restructuring(e)	5	8	2	9	11	2	2
Gain on settlement of litigation(f)	(51)						(51)
Net (loss) earnings attributable to Toys Japan noncontrolling interest(g)	(8)	(7)	2	(1)		(1)	(7)
(Gain) loss on sale of properties(h)	(6)	(5)	(33)	(110)	3	(4)	(1)
Gift card breakage accounting change(i)		(59)					
McDonald s Japan contract termination(j)		14	5				
Gain on liquidation of TRU (HK) Limited(k)		(39)					
Transaction and related costs(l)					410		

Contract settlement fees and other(m)							
Adjusted EBITDA	$ 1,130	$ 990	$ 1,095	$ 982	$ 730	$ 261	$ 264

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(a) Reserve recorded for certain legal matters.

(b) Represents a non-cash cumulative correction of prior period straight-line lease accounting.

(c) Represents the fees paid to the Sponsors in accordance with the advisory agreement. The agreement will be terminated in connection with this offering. See Certain Relationships and Related Party Transactions.

(d) These impairments were primarily due to the identification of underperforming stores, the relocation of certain stores and a decrease in real estate market values.

(e) Restructuring and other charges consist primarily of costs incurred from the Company s 2003 and 2005 restructuring initiatives. The additional charges are primarily due to changes in management s estimates for events such as lease terminations, assignments and sublease income adjustments.

(f) Represents a $51 million gain recorded in Other (income) expense, net related to the litigation settlement with Amazon in fiscal 2009.

(g) Excludes noncontrolling interest in Toys R Us Japan.

(h) During fiscal 2009, we sold idle properties which resulted in gains of approximately $6 million. During fiscal 2008, Toys R Us Iberia Real Estate S.L., an indirect wholly-owned subsidiary, sold property resulting in a net gain of $14 million. At the time of the sale, Toys R Us Iberia S.A., its parent company, leased back a portion of the property. Due to the leaseback, we recognized $4 million of the net gain and deferred the remaining $10 million. During fiscal 2007, we sold our interest in an idle distribution center for gross proceeds of approximately $29 million, resulting in a gain of $18 million and sold 4 properties for gross proceeds of $14 million, resulting in a gain of $5 million as part of the agreement with Vornado Surplus 2006 Realty, LLC. In addition, we consummated a lease termination agreement resulting in a net gain of $10 million.

During fiscal 2006, Toys R Us-Delaware, Inc. (Toys-Delaware) and MAP 2005 Real Estate, LLC, both wholly-owned direct subsidiaries of the Company, consummated the sale of their interest in 38 properties, primarily to an affiliate of Vornado, for gross proceeds of approximately $178 million, resulting in a gain of $91 million. In addition, during fiscal 2006 we sold our interest in and assets related to a leased property, resulting in a gain of $21 million.

During the twenty-six weeks ended July 31, 2010 and August 1, 2009, we sold idle properties which resulted in gains of approximately $4 million and $1 million, respectively.

(i) During the fourth quarter of fiscal 2008, the Company changed its method for recording gift card breakage income to recognize breakage income and derecognize the gift card liability for unredeemed gift cards in proportion to actual redemptions of gift cards. As a result, the adjustment recorded in fiscal 2008 resulted in an additional $59 million of gift card breakage income.

(j) In fiscal 2008, a settlement was reached in which Toys Japan and McDonald s Japan agreed to the termination of the service agreement and the payment by Toys Japan of ¥2.0 billion ($19 million as of May 13, 2008) to McDonald s Japan. The Company had previously established a reserve of $5 million in fiscal 2007.

(k) In fiscal 2008, the operations of TRU (HK) Limited, our wholly-owned subsidiary, were substantially liquidated. As a result, we recognized a $39 million gain.

(l) These costs reflect $148 million of expenses related to the 2005 acquisition, compensation expenses associated with the 2005 acquisition related to stock options and restricted stock of $222 million, as well as severance, bonuses and related payroll taxes of $40 million.

(m) This amount resulted from the loss on early extinguishment of debt of $7 million related to the purchase of the notes associated with our equity security units and a contract settlement fee of $15 million related to the early termination of our synthetic lease of our headquarters located in Wayne, New Jersey.

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RISK FACTORS

An investment in our common stock involves substantial risk. You should carefully consider the following risks as well as the other information included in this prospectus, including Management s Discussion and Analysis of Financial Condition and Results of Operations and our financial statements and related notes, before investing in our common stock. Any of the following risks could materially and adversely affect our business, financial condition or results of operations. In such a case, the trading price of the common stock could decline and you may lose all or part of your investment in our company.

Risks Relating to Our Business

Our business is highly seasonal, and our financial performance depends on the results of the fourth quarter of each fiscal year and, as a result, our operating results could be materially adversely affected if we achieve less than satisfactory sales prior to or during the holiday season.

Our business is highly seasonal. During fiscals 2009, 2008 and 2007 approximately 43%, 40% and 42%, respectively, of our total Net sales were generated in the fourth quarter. It is typically the case that we incur net losses in each of the first three quarters of the year, with all of our net earnings and cash flows from operations being generated in the fourth quarter. As a result, we depend significantly upon the fourth quarter holiday selling season. If we achieve less than satisfactory sales, operating earnings or cash flows from operating activities during the fourth quarter, we may not be able to compensate sufficiently for the lower sales, operating earnings or cash flows from operating activities during the first three quarters of the fiscal year. Our results in any given period may be affected by dates on which important holidays fall and the shopping patterns relating to those holidays. Additionally, the concentrated nature of our seasonal sales means that the Company s operating results could be materially adversely affected by natural disasters and labor strikes, work stoppages, terrorist acts or disruptive global political events, prior to or during the holiday season, as described below.

Our industry is highly competitive and competitive conditions may adversely affect our revenues and overall profitability.

The retail industry is highly and increasingly competitive and our results of operations are sensitive to, and may be adversely affected by, competitive pricing, promotional pressures, additional competitor store openings and other factors. As a specialty retailer, that primarily focuses on toys and juvenile products, we compete with discount and mass merchandisers, such as Wal-Mart and Target, electronics retailers, national and regional specialty chains, as well as local retailers in the geographic areas we serve. We also compete with national and local discount stores, department stores, supermarkets and warehouse clubs, as well as Internet and catalog businesses. Competition is principally based on product variety, quality, availability, price, convenience or store location, advertising and promotion, customer support and service. We believe that some of our competitors in the toys market and juvenile products market, as well as in the other markets in which we compete, have a larger market share than our market share. In addition, some of our competitors have greater financial resources, lower merchandise acquisition costs and lower operating expenses than we do.

Much of the merchandise we sell is also available from various retailers at competitive prices. Discount and mass merchandisers use aggressive pricing policies and enlarged toy-selling areas during the holiday season to build traffic for other store departments. Our business is vulnerable to shifts in demand and pricing, as well as consumer preferences. Competition in the video game market has increased in recent years as mass merchandisers have expanded their offerings in this market, and as alternative sales channels (such as the Internet) have grown in importance.

The baby registry market is highly competitive, with competition based on convenience, quality and selection of merchandise offerings and functionality. Our baby registry primarily competes with the baby registries of mass merchandisers and other specialty format and regional retailers. Some of our competitors have been aggressively advertising and marketing their baby registries through national television and magazine campaigns. Within the past few years, the number of multiple registries and on-line registries has steadily increased. These trends present consumers with more choices for their baby registry needs, and as a result, increase competition for our baby registry.

If we fail to compete successfully, we could face lower sales and may decide or be compelled to offer greater discounts to our customers, which could result in decreased profitability.

Our sales may be adversely affected by changes in economic factors and changes in consumer spending patterns.

Many economic and other factors outside our control, including consumer confidence, consumer spending levels, employment levels, consumer debt levels, inflation and deflation, as well as the availability of consumer credit, affect consumer spending habits. A significant deterioration in the global financial markets and economic environment, recessions or an uncertain economic outlook adversely affects consumer spending habits and results in lower levels of economic activity. The domestic and international political situation, including the economic health of various political jurisdictions, also affects economic conditions and consumer confidence. Any of these events and factors could cause consumers to curtail spending and could have a negative impact on our financial performance and position in future fiscal periods.

Since fiscal 2008, there has been a deterioration in the global financial markets and economic environment, which has negatively impacted consumer spending. In response, we have taken steps to drive profitable sales and to curtail capital spending and operating expenses wherever prudent. However, there is a risk that our steps to respond to these economic conditions may be ill-conceived or ineffective. These adverse trends in economic conditions may worsen to the point that even well-conceived responses would not be sufficiently effective to counteract the impacts of these trends. In such cases, there would be a negative impact on our financial performance and position in future fiscal periods.

Our operations have significant liquidity and capital requirements and depend on the availability of adequate financing on reasonable terms. If our lenders are unable to fund borrowings under their credit commitments or we are unable to borrow, it could have a significant negative effect on our business.

We have significant liquidity and capital requirements. Among other things, the seasonality of our businesses requires us to purchase merchandise well in advance of the fourth quarter holiday selling season. We depend on our ability to generate cash flows from operating activities, as well as on borrowings under our revolving credit facilities and our credit lines, to finance the carrying costs of this inventory and to pay for capital expenditures and operating expenses. For fiscal 2009, peak borrowings under our various credit lines were $784 million as we purchased merchandise for the fourth quarter holiday selling season. If our lenders are unable to fund borrowings under their credit commitments or we are unable to borrow, it could have a significant negative effect on our business. In addition, any adverse change to our credit ratings could negatively impact our ability to refinance our debt on satisfactory terms and could have the effect of increasing our financing costs. While we believe we currently have adequate sources of funds to provide for our ongoing operations and capital requirements for the next 12 months, any inability on our part to have future access to financing, when needed, would have a negative effect on our business.

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A loss of, or reduction in, trade credit from our vendors could reduce our liquidity, increase our working capital needs and/or limit our ability to purchase products.

We purchase products for resale from our vendors, who may seek credit insurance to protect against non-payment of amounts due to them. However, as a result of deteriorating economic conditions and higher claims costs, credit insurers have curtailed or eliminated coverage to vendors (as it was the case in the recent disruptions to the trade credit market in the U.K.) and may continue to do so in the future. If credit insurance is not available to vendors at reasonable terms or at all, vendors may demand accelerated payment of amounts due to them or require advance payments or letters of credit before goods are shipped to us. Such demands could have a significant adverse impact on our inventory levels and operating cash flow and negatively impact our liquidity. Any such disruptions could increase the costs to us of financing our inventory or negatively impact our ability to deliver products to our customers, which could in turn negatively affect our financial performance.

We may not retain or attract customers if we fail to successfully implement our strategic initiatives, which could result in lower sales and a failure to realize the benefit of the expenditures incurred for these initiatives.

We continue to implement a series of customer-oriented strategic programs designed to differentiate and strengthen our core merchandise content and service levels and to expand and enhance our merchandise offerings. We seek to improve the effectiveness of our marketing and advertising programs for our R Us stores. The success of these and other initiatives will depend on various factors, including the implementation of our growth strategy, the appeal of our store formats, our ability to offer new products to customers, our financial condition, our ability to respond to changing consumer preferences and competitive and economic conditions. We continuously endeavor to minimize our operating expenses, without adversely affecting the profitability of the business. If we fail to implement successfully some or all of our strategic initiatives, we may be unable to retain or attract customers, which could result in lower sales and a failure to realize the benefit of the expenditures incurred for these initiatives.

If we cannot implement our juvenile integration strategy or open new stores, our future growth will be adversely affected.

Our growth is dependent on both increases in sales in existing stores and the ability to successfully implement our juvenile integration strategy and open profitable new stores. Increases in sales in existing stores are dependent on factors such as competition, merchandise selection, store operations and other factors discussed in these Risk Factors. Our ability to successfully implement our juvenile integration strategy in a timely and cost effective manner or open new stores and expand into additional market areas depends in part on the following factors, which are in part beyond our control:

- the availability of attractive store locations and the ability to accurately assess the demographic or retail environment and customer demand at a given location;
- the ability to negotiate favorable lease terms and obtain the necessary permits and zoning approvals;
- the absence of occupancy delays;
- the ability to construct, furnish and supply a store in a timely and cost effective manner;
- the ability to hire and train new personnel, especially store managers, in a cost effective manner;
- costs of integration, which may be higher than anticipated;
- general economic conditions; and

the availability of sufficient funds for the expansion.

Delays or failures in successfully implementing our juvenile integration strategy and opening new stores, or achieving lower than expected sales in integrated or new stores, or drawing a greater than expected proportion of sales in integrated or new stores from existing stores, could materially adversely affect our growth and/or profitability. In addition, we may not be able to anticipate all of the challenges imposed by the expansion of our operations and, as a result, may not meet our targets for integrating, opening new stores or relocating stores or expanding profitably.

Some of our new stores may be located in areas where we have little or no meaningful experience. Those markets may have different market conditions, consumer preferences and discretionary spending patterns than our existing markets, which may cause our new stores to be less successful than stores in our existing markets. Other new stores may be located in areas where we have existing stores. Although we have experience in these markets, increasing the number of locations may result in unanticipated over-saturation of markets and temporarily or permanently divert customers and sales from our existing stores, thereby adversely affecting our overall financial performance.

Our sales may be adversely affected if we fail to respond to changes in consumer preferences in a timely manner.

Our financial performance depends on our ability to identify, originate and define product trends, as well as to anticipate, gauge and react to changing consumer preferences in a timely manner. Our products must appeal to a broad range of consumers whose preferences cannot be predicted with certainty and are subject to change. Our business fluctuates according to changes in consumer preferences dictated in part by fashion trends, perceived value and season. These fluctuations affect the merchandise in stock since purchase orders are written well in advance of the holiday season and, at times, before fashion trends and high-demand brands are evidenced by consumer purchases. If we overestimate the market for our products, we may be faced with significant excess inventories, which could result in increased expenses and reduced margins associated with having to liquidate obsolete inventory at lower prices. Conversely, if we underestimate the market for our products, we will miss opportunities for increased sales and profits, which would place us at a competitive disadvantage.

Sales of video games and video game systems tend to be cyclical, which may result in fluctuations in our results of operations, and may be adversely affected if products are sold through alternative channels.

Sales of video games and video game systems, which have tended to account for 10% to 13% of our annual net sales for fiscals 2009, 2008 and 2007, have been cyclical in nature in response to the introduction and maturation of new technology. Following the introduction of new video game systems, sales of these systems and related software and accessories generally increase due to initial demand, while sales of older systems and related products generally decrease. Moreover, competition within the video game market has increased in recent years and, due to the large size of this product category, fluctuations in this market could have a material adverse impact on our sales and profits trends. Additionally, if video game system manufacturers fail to develop new hardware systems, or if new video products are sold in channels other than traditional retail stores, including through direct online distribution to customers, our sales of video game products could decline, which would negatively impact our financial performance.

The success and expansion of our on-line business depends on our ability to provide quality service to our Internet customers and if we are not able to provide such services, our future growth will be adversely affected.

Our Internet operations are subject to a number of risks and uncertainties which are beyond our control, including the following:

- changes in consumer willingness to purchase goods via the Internet;

- increases in software filters that may inhibit our ability to market our products through e-mail messages to our customers and increases in consumer privacy concerns relating to the Internet;
- changes in technology;
- changes in applicable federal and state regulation, such as the Federal Trade Commission Act, the Children s Online Privacy Act, the Fair Credit Reporting Act and the Gramm-Leach-Bliley Act and similar types of international laws;
- breaches of Internet security;
- failure of our Internet service providers to perform their services properly and in a timely and efficient manner;
- failures in our Internet infrastructure or the failure of systems or third parties, such as telephone or electric power service, resulting in website downtime or other problems;
- failure by us to process on-line customer orders properly and on time, which may negatively impact future on-line and in-store purchases by such customers; and
- failure by our service provider to provide warehousing and fulfillment services, which may negatively impact future on-line and in-store purchases by customers.

If we are not able to provide satisfactory service to our Internet customers, our future growth will be adversely affected.

We depend on key vendors to supply the merchandise that we sell to our customers and our vendors failure to supply quality merchandise in a timely manner may damage our reputation and brands and harm our business.

Our performance depends, in part, on our ability to purchase our merchandise in sufficient quantities at competitive prices. We purchase our merchandise from numerous international and domestic manufacturers and importers. We have no contractual assurances of continued supply, pricing or access to new products, and any vendor could change the terms upon which they sell to us or discontinue selling to us at any time. We may not be able to acquire desired merchandise in sufficient quantities on terms acceptable to us in the future. Better than expected sales demand may also lead to customer backorders and lower in-stock positions of our merchandise.

As of fiscal 2009, we had approximately 3,700 active vendor relationships through which we procure the merchandise that we offer to our guests. For fiscal 2009, our top 20 vendors worldwide, based on our purchase volume in U.S. dollars, represented approximately 41% of the total products we purchased. An inability to acquire suitable merchandise on acceptable terms or the loss of one or more key vendors could have a negative effect on our business and operating results and could cause us to miss products that we feel are important to our assortment. We may not be able to develop relationships with new vendors, and products from alternative sources, if any, may be of a lesser quality and/or more expensive than those from existing vendors.

In addition, our vendors are subject to various risks, including raw material costs, inflation, labor disputes, union organizing activities, financial liquidity, product merchantability, inclement weather, natural disasters and general economic and political conditions that could limit our vendors ability to provide us with quality merchandise on a timely basis and at prices and payment terms that are commercially acceptable. For these or other reasons, one or more of our vendors might not adhere to our quality control standards, and we might not identify the deficiency before merchandise ships to our stores or customers. In addition, our vendors may have difficulty adjusting to our changing demands and growing business. Our vendors failure to manufacture or import quality merchandise in a timely

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and effective manner could damage our reputation and brands, and could lead to an increase in customer litigation against us and an attendant increase in our routine and non-routine litigation costs. Further, any merchandise that does not meet our quality standards could become subject to a recall, which could damage our reputation and brands and harm our business.

The decrease of birth rates in countries where we operate could negatively affect our business.

Most of our end-customers are newborns and children and, as a result, our revenues are dependent on the birth rates in countries where we operate. In recent years, many countries have experienced a sharp drop in birth rates as their population ages and education and income levels increase. A continued and significant decline in the number of newborns and children in these countries could have a material adverse effect on our operating results.

If current store locations become unattractive, and attractive new locations are not available for a reasonable price, our ability to implement our growth strategy will be adversely affected.

The success of any store depends in substantial part on its location. There can be no assurance that current locations will continue to be attractive as demographic patterns change. Neighborhood or economic conditions where stores are located could decline in the future, resulting in potentially reduced sales in these locations. If we cannot obtain desirable locations at reasonable prices, our ability to implement our growth strategy will be adversely affected.

If we are unable to renew or replace our current store leases or if we are unable to enter into leases for additional stores on favorable terms, or if one or more of our current leases are terminated prior to expiration of their stated term and we cannot find suitable alternate locations, our growth and profitability could be negatively impacted.

We currently have ground and store leasehold interests in approximately 70% of our domestic and international store locations. Most of our current leases provide for our unilateral option to renew for several additional rental periods at specific rental rates. Our ability to re-negotiate favorable terms on an expiring lease or to negotiate favorable terms for a suitable alternate location, and our ability to negotiate favorable lease terms for additional store locations could depend on conditions in the real estate market, competition for desirable properties and our relationships with current and prospective landlords or may depend on other factors that are not within our control. Any or all of these factors and conditions could negatively impact our growth and profitability.

Our business, financial condition and results of operations are subject to risks arising from the international scope of our operations which could negatively impact our financial condition and results of operations.

We conduct a significant portion of our business in many countries around the world. For the twenty-six weeks ended July 31, 2010 and for the 2009 and 2008 fiscal years, approximately 36.8%, 38.7% and 38.2% of our Net sales were generated outside the U.S., respectively. In addition, as of January 31, 2010, approximately 35.3% of our long-lived assets were located outside of the United States. All of our foreign operations are subject to risks inherent in conducting business abroad, including the challenges of different economic conditions in each of the countries, possible nationalization or expropriation, price and currency exchange controls, fluctuations in the relative values of currencies as described below, political instability and restrictive governmental actions.

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Our business is subject to fluctuations in foreign currency exchange and such fluctuations may have a material adverse effect on our business, financial condition and results of operations.

Exchange rate fluctuations may affect the translated value of our earnings and cash flow associated with our international operations, as well as the translation of net asset or liability positions that are denominated in foreign currencies. In countries outside of the United States where we operate stores, we generate revenues and incur operating expenses and selling, general and administrative expenses denominated in local currencies. In many countries where we do not operate stores, our licensees pay royalties in U.S. dollars. However, as the royalties are calculated based on local currency sales, our revenues are still impacted by fluctuations in exchange rates. In fiscal years 2009 and 2008, 38.7% and 38.2% of our Net sales were completed in a currency other than the U.S. dollar, the majority of which were denominated in euros, yen and pounds. In fiscal 2009, our reported operating earnings would have decreased or increased $28 million if all foreign currencies uniformly weakened or strengthened by 10% relative to the U.S. dollar. Since the start of fiscal 2010, the U.S. dollar strengthened significantly against the euro and the pound and weakened against the yen and the Canadian dollar. In addition, our exposure to foreign currency exchange rate fluctuations will grow if the relative contribution of our operations outside the United States increases.

We enter into foreign exchange agreements from time to time with financial institutions to reduce our exposure to fluctuations in currency exchange rates referred to as hedging activities. However, these hedging activities may not eliminate foreign currency risk entirely and involve costs and risks of their own. Although we hedge some exposures to changes in foreign currency exchange rates arising in the ordinary course of business, foreign currency fluctuations may have a material adverse effect on our business, financial condition and results of operations.

Our results may be adversely affected by fluctuations in raw material and energy costs.

Our results may be affected by the prices of the components and raw materials used in the manufacture of our toys and juvenile products. These prices may fluctuate based on a number of factors beyond our control, including: oil prices, changes in supply and demand, general economic conditions, labor costs, competition, import duties, tariffs, currency exchange rates and government regulation. In addition, energy costs have fluctuated dramatically in the past. These fluctuations may result in an increase in our transportation costs for distribution, utility costs for our retail stores and overall costs to purchase products from our vendors.

We may not be able to adjust the prices of our products, especially in the short-term, to recover these cost increases in raw materials and energy. A continual rise in raw material and energy costs could adversely affect consumer spending and demand for our products and increase our operating costs, both of which could have a material adverse effect on our financial condition and results of operations.

A significant disruption to our distribution network or to the timely receipt of inventory could adversely impact sales or increase our transportation costs, which would decrease our profits.

We rely on our ability to replenish depleted inventory in our stores through deliveries to our distribution centers from vendors and then from the distribution centers or direct ship vendors to our stores by various means of transportation, including shipments by sea, rail, air and truck. Unexpected delays in those deliveries or increases in transportation costs (including through increased fuel costs)

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could significantly decrease our ability to make sales and earn profits. In addition, labor shortages or labor disagreements in the transportation industry or long-term disruptions to the national and international transportation infrastructure that lead to delays or interruptions of deliveries could negatively affect our business.

Product safety issues, including product recalls, could harm our reputation, divert resources, reduce sales and increase costs.

The products we sell in our stores are subject to regulation by the Consumer Product Safety Commission and similar state and international regulatory authorities. Such products could be subject to recalls and other actions by these authorities. Product safety concerns may require us to voluntarily remove selected products from our stores. Such recalls and voluntary removal of products can result in, among other things, lost sales, diverted resources, potential harm to our reputation and increased customer service costs, which could have a material adverse effect on our financial condition.

Our business exposes us to personal injury and product liability claims which could result in adverse publicity and harm to our brands and our results of operations.

We are from time to time subject to claims due to the injury of an individual in our stores or on our property. In addition, we have in the past been subject to product liability claims for the products that we sell. Subject to certain exceptions, our purchase orders generally require the manufacturer to indemnify us against any product liability claims; however, if the manufacturer does not have insurance or becomes insolvent, there is a risk we would not be indemnified. Any personal injury or product liability claim made against us, whether or not it has merit, could be time consuming and costly to defend, resulting in adverse publicity, or damage to our reputation, and have an adverse effect on our results of operations.

Adverse litigation judgments or settlements resulting from legal proceedings in which we may be involved could expose us to monetary damages or limit our ability to operate our business.

We are involved in private actions, investigations and various other legal proceedings by employees, suppliers, competitors, shareholders, government agencies or others. For instance, on July 15, 2009, the United States District Court for the Eastern District of Pennsylvania granted the class plaintiffs motion for class certification in a consumer class action commenced in January 2006, which was consolidated with an action brought by two Internet retailers that was commenced in December 2005. Both actions allege that Babies R Us agreed with certain baby product manufacturers to impose, maintain and/or enforce minimum price agreements in violation of antitrust laws. In addition, in December 2009, a third internet retailer filed a similar action and another class action was commenced making similar allegations involving most of the same defendants. Additionally, the Federal Trade Commission (FTC) notified us in April 2009 that they had opened an investigation related to the issues in those cases and to confirm our compliance with a 1998 FTC Final Order that prohibits us from, among other things, influencing our suppliers to limit sales of products to other retailers, including price club warehouses.

The results of such litigation, investigations and other legal proceedings are inherently unpredictable. Any claims against us, whether meritorious or not, could be time consuming, result in costly litigation, require significant amounts of management time and divert significant resources. If any of these legal proceedings were to be determined adversely to us, there could be a material adverse effect on our business, financial condition and results of operations.

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We are subject to certain regulatory and legal requirements. If we fail to comply with regulatory or legal requirements, our business and financial results may be adversely affected.

We are subject to numerous regulatory and legal requirements. Our policies, procedures and internal controls are designed to comply with all applicable laws and regulations, including those imposed by the Sarbanes-Oxley Act of 2002 and the Securities and Exchange Commission. In addition, our business activities require us to comply with complex regulatory and legal issues on a local, national and worldwide basis (including, in some cases, more stringent local labor law or regulations). Failure to comply with such laws and regulations could adversely affect our operations and financial results, involve significant expense and divert management s attention and resources from other matters, which in turn could harm our business.

Our business operations could be disrupted if our information technology systems fail to perform adequately or we are unable to protect the integrity and security of our customers information.

We depend largely upon our information technology systems in the conduct of all aspects of our operations. If our information technology systems fail to perform as anticipated, we could experience difficulties in virtually any area of our operations, including but not limited to replenishing inventories or in delivering our products to store locations in response to consumer demands. Any of these or other systems-related problems could, in turn, adversely affect our sales and profitability.

Additionally, a compromise of our security systems (or a design flaw in our system environment) could result in unauthorized access to certain personal information about our customers which could adversely affect our reputation with our customers and others, as well as our operations, and could result in litigation against us or the imposition of penalties. In addition, a security breach could require that we expend significant additional resources related to our information security systems.

Natural disasters, inclement weather, pandemic outbreaks, terrorist acts or disruptive global political events could cause permanent or temporary distribution center or store closures, impair our ability to purchase, receive or replenish inventory, or decrease customer traffic, all of which could result in lost sales and otherwise adversely affect our financial performance.

The occurrence of one or more natural disasters, such as hurricanes, fires, floods, earthquakes, tornados and volcano eruptions, or inclement weather such as frequent or unusually heavy snow, ice or rain storms, or extended periods of unseasonable temperatures, or the occurrence of pandemic outbreaks, labor strikes, work stoppages, terrorist acts or disruptive global political events, such as civil unrest in countries in which our suppliers are located, or similar disruptions could adversely affect our operations and financial performance. To the extent these events impact one or more of our key vendors or result in the closure of one or more of our distribution centers or a significant number of stores, our operations and financial performance could be materially adversely affected through an inability to make deliveries to our stores and through lost sales. In addition, these events could result in increases in fuel (or other energy) prices or a fuel shortage, delays in opening new stores, the temporary lack of an adequate work force in a market, the temporary or long-term disruption in the supply of products from some local and overseas vendor, the temporary disruption in the transport of goods from overseas, delay in the delivery of goods to our distribution centers or stores, the temporary reduction in the availability of products in our stores and disruption to our information systems. These events also can have indirect consequences such as increases in the costs of insurance if they result in significant loss of property or other insurable damage.

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Our results of operations could suffer if we lose key management or are unable to attract and retain experienced senior management for our business.

Our future success depends to a significant degree on the skills, experience and efforts of our senior management team. The loss of services of any of these individuals, or the inability by us to attract and retain qualified individuals for key management positions, could harm our business and financial performance.

Because of our extensive international operations, we could be adversely affected by violations of the U.S. Foreign Corrupt Practices Act and similar worldwide anti-bribery laws.

The U.S. Foreign Corrupt Practices Act, and similar worldwide anti-bribery laws generally prohibit companies and their intermediaries from making improper payments to non-U.S. officials for the purpose of obtaining or retaining business. Our policies mandate compliance with these anti-bribery laws. Despite our training and compliance program, we cannot assure you that our internal control policies and procedures always will protect us from reckless or criminal acts committed by our employees or agents. Violations of these laws, or allegations of such violations, could disrupt our business and result in a material adverse effect on our financial condition, results of operations and cash flows.

International events could delay or prevent the delivery of products to our stores, which could negatively affect our sales and profitability.

A significant portion of products we sell are manufactured outside of the United States, primarily in Asia. As a result, any event causing a disruption of imports, including labor strikes, work stoppages, boycotts, safety issues on materials, the imposition of trade restrictions in the form of tariffs, embargoes or export controls, anti-dumping duties, port security or other events that could slow port activities, could increase the cost and reduce the supply of products available to us. In addition, port-labor issues, rail congestion and trucking shortages can have an impact on all direct importers. Although we attempt to anticipate and manage such situations, both our sales and profitability could be adversely impacted by any such developments in the future. These and other international events could negatively affect our sales and profitability.

We may experience fluctuations in our tax obligations and effective tax rate, which could materially and adversely affect our results of operations.

We are subject to taxes in the United States and numerous international jurisdictions. We record tax expense based on our estimates of future tax payments, which include reserves for estimates of probable settlements of international and domestic tax audits. At any one time, many tax years are subject to audit by various taxing jurisdictions. The results of these audits and negotiations with taxing authorities may affect the ultimate settlement of these issues. As a result, we expect that throughout the year there could be ongoing variability in our quarterly tax rates as taxable events occur and exposures are re-evaluated. Further, our effective tax rate in a given financial statement period may be materially impacted by changes in the mix and level of earnings by taxing jurisdiction or by changes to existing accounting rules or regulations. Fluctuations in our tax obligations and effective tax rate could materially and adversely affect our results of operations.

Changes to accounting rules or regulations may adversely affect our results of operations.

Changes to existing accounting rules or regulations may impact our future results of operations or cause the perception that we are more highly leveraged. Other new accounting rules or regulations and varying interpretations of existing accounting rules or regulations have occurred and may occur in the future. For instance, accounting regulatory authorities have indicated that they may begin to require

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lessees to capitalize operating leases in their financial statements in the next few years. If adopted, such change would require us to record significant capital lease obligations on our balance sheet and make other changes to our financial statements. This and other future changes to accounting rules or regulations could adversely affect our results of operations and financial position.

Our total assets include goodwill and substantial amounts of property and equipment. Changes to estimates or projections related to such assets, or operating results that are lower than our current estimates at certain store locations, may cause us to incur impairment charges that could adversely affect our results of operations.

Our total assets include substantial amounts of property, equipment and goodwill. We make certain estimates and projections in connection with impairment analyses for these assets, in accordance with FASB Accounting Standards Codification (Codification or ASC) Topic 360, Property, Plant and Equipment (ASC 360), and ASC Topic 350, Intangibles Goodwill and Other (ASC 350). We also review the carrying value of these assets for impairment whenever events or changes in circumstances indicate that the carrying value of the asset may not be recoverable in accordance with ASC 360 or ASC 350. We will record an impairment loss when the carrying value of the underlying asset, asset group or reporting unit exceeds its fair value. These calculations require us to make a number of estimates and projections of future results. If these estimates or projections change, we may be required to record additional impairment charges on certain of these assets. If these impairment charges are significant, our results of operations would be adversely affected.

Risks Related to Our Substantial Indebtedness

Our substantial indebtedness could adversely affect our ability to raise additional capital to fund our operations, limit our ability to react to changes in the economy or our industries, expose us to interest rate risk to the extent of our variable rate debt and prevent us from meeting our obligations under our various debt instruments.

We are highly leveraged. As of July 31, 2010, our total indebtedness was $5,353 million, of which $2,561 million was secured indebtedness and $2,120 million of which matures before the end of fiscal 2012. Our substantial indebtedness could have significant consequences, including, among others, the following:

- increasing our vulnerability to general economic and industry conditions;

- requiring a substantial portion of cash flows from operating activities to be dedicated to the payment of principal and interest on our indebtedness, and as a result, reducing our ability to use our cash flows to fund our operations and capital expenditures, capitalize on future business opportunities and expand our business and execute our strategy;

- increasing the difficulty for us to make scheduled payments on our outstanding debt, as our business may not be able to generate sufficient cash flows from operating activities to meet our debt service obligations;

- exposing us to the risk of increased interest expense due to changes in borrowing spreads and short-term interest rates;

- causing us to make non-strategic divestitures;

- limiting our ability to obtain additional financing for working capital, capital expenditures, debt service requirements and general, corporate or other purposes; and

- limiting our ability to adjust to changing market conditions and reacting to competitive pressure and placing us at a competitive disadvantage compared to our competitors who are less highly leveraged.

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We may be able to incur additional indebtedness in the future, including under our current revolving credit agreements, subject to the restrictions contained in our debt instruments. If new indebtedness is added to our current debt levels, the related risks that we now face could intensify.

We may not be able to generate sufficient cash to service all of our indebtedness and may not be able to refinance our indebtedness on favorable terms. If we are unable to do so, we may be forced to take other actions to satisfy our obligations under our indebtedness, which may not be successful.

Our ability to make scheduled payments on or to refinance our debt obligations depends on our financial condition and operating performance, our lenders financial stability, which are subject to prevailing global economic and market conditions and to certain financial, business and other factors beyond our control. Even if we were able to refinance or obtain additional financing, the costs of new indebtedness could be substantially higher than the costs of our existing indebtedness.

If our cash flows and capital resources are insufficient to fund our debt service obligations or we are unable to refinance our indebtedness, we may be forced to reduce or delay investments and capital expenditures, or to sell assets, seek additional capital or restructure our indebtedness. These alternative measures may not be successful and may not permit us to meet our scheduled debt service obligations. If our operating results and available cash are insufficient to meet our debt service obligations, we could face substantial liquidity problems and might be required to dispose of material assets or operations to meet our debt service and other obligations. We may not be able to consummate those dispositions, or the proceeds from the dispositions may not be adequate to meet any debt service obligations then due. If we were unable to repay amounts when due, the lenders could proceed against the collateral granted to them to secure that indebtedness.

Our debt agreements contain covenants that limit our flexibility in operating our business.

Toys R Us, Inc. is a holding company and conducts its operations through its subsidiaries, certain of which have incurred their own indebtedness. As specified in certain of our subsidiaries debt agreements, there are restrictions on our ability to obtain funds from our subsidiaries through dividends, loans or advances. The agreements governing our indebtedness contain various covenants that limit our ability to engage in specified types of transactions, and may adversely affect our ability to operate our business. Among other things, these covenants limit our and our subsidiaries ability to:

- incur additional indebtedness;
- transfer money between the parent company and our various subsidiaries;
- pay dividends on, repurchase or make distributions with respect to our 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.

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A breach of any of these covenants could result in default under one or more of our debt agreements, which could prompt the lenders to declare all amounts outstanding under the debt agreements to be immediately due and payable and terminate all commitments to extend further credit. If we were unable to repay those amounts, the lenders could proceed against the collateral granted to them to secure that indebtedness. If the lenders under the debt agreements accelerate the repayment of borrowings, we may not have sufficient assets and funds to repay the borrowings under our debt agreements.

Risks Related to this Offering and Ownership of Our Common Stock

An active, liquid trading market for our common stock may not develop.

After our 2005 acquisition and prior to this offering, there has not been a public market for our common stock. We cannot predict the extent to which investor interest in our company will lead to the development of a trading market on the New York Stock Exchange or otherwise or how active and liquid that market may become. If an active and liquid trading market does not develop, you may have difficulty selling any of our common stock that you purchase. The initial public offering price for the shares will be determined by negotiations between us and the underwriters and may not be indicative of prices that will prevail in the open market following this offering. The market price of our common stock may decline below the initial offering price, and you may not be able to sell your shares of our common stock at or above the price you paid in this offering, or at all.

You will incur immediate and substantial dilution in the net tangible book value of the shares you purchase in this offering.

Prior investors have paid substantially less per share of our common stock than the price in this offering. The initial public offering price of our common stock is substantially higher than the net tangible book value per share of outstanding common stock prior to completion of the offering. Based on our net tangible book value as of July 31, 2010 and upon the issuance and sale of shares of common stock by us at an assumed initial public offering price of $ per share (the midpoint of the estimated initial public offering price range indicated on the cover of this prospectus), if you purchase our common stock in this offering, you will pay more for your shares than the amounts paid by our existing shareholders for their shares and you will suffer immediate dilution of approximately $ per share in net tangible book value after giving effect to the sale of shares of our common stock in this offering assuming an initial public offering price of $ per share, less the underwriting discounts and commissions and the estimated offering expenses payable by us, and without taking into account any other changes in such net tangible book value after July 31, 2010. We also have a large number of outstanding stock options to purchase common stock with exercise prices that are below the estimated initial public offering price of our common stock. To the extent that these options are exercised, you will experience further dilution. See Dilution.

Our stock price may change significantly following the offering, and you could lose all or part of your investment as a result.

We and the underwriters will negotiate to determine the initial public offering price. You may not be able to resell your shares at or above the initial public offering price due to a number of factors such as those listed in Risks Relating to Our Business and the following, most of which are beyond our control:

- quarterly variations in our results of operations;
- results of operations that vary from the expectations of securities analysts and investors;
- results of operations that vary from those of our competitors;

- changes in expectations as to our future financial performance, including financial estimates by securities analysts and investors;
- announcements by us, our competitors or our vendors of significant contracts, acquisitions, joint marketing relationships, joint ventures or capital commitments;
- announcements by third parties of significant claims or proceedings against us;
- increases in prices of raw materials for our products, fuel or our goods;
- future sales of our common stock; and
- general domestic and international economic conditions.

Furthermore, the stock market recently has experienced extreme volatility that in some cases has been unrelated or disproportionate to the operating performance of particular companies. These broad market and industry fluctuations may adversely affect the market price of our common stock, regardless of our actual operating performance.

In the past, following periods of market volatility, shareholders have instituted securities class action litigation. If we were involved in securities litigation, it could have a substantial cost and divert resources and the attention of executive management from our business regardless of the outcome of such litigation.

Our operating results may fluctuate in future periods which could cause the market price of our common stock to be volatile or to decline.

Our operating results for any one quarter are not necessarily indicative of results to be expected for any other quarter or for any year, and sales and profits for any future period may decrease. Our operating results may fall below our expectations or the expectations of investors or industry analysts in one or more future periods. Any such shortfall could results in a significant decline in the price of our common stock.

If we or our existing investors sell additional shares of our common stock after this offering, the market price of our common stock could decline.

The market price of our common stock could decline as a result of sales of a large number of shares of common stock in the market after this offering, or the perception that such sales could occur. These sales, or the possibility that these sales may occur, also might make it more difficult for us to sell equity securities in the future at a time and at a price that we deem appropriate. After the completion of this offering, we will have shares of common stock outstanding (if the underwriters exercise their option to purchase additional shares in full). This number includes shares being sold in this offering, which may be resold immediately in the public market.

We, our directors and officers and the Sponsors have agreed not to offer, sell, dispose of or hedge, directly or indirectly, any common stock without the prior written consent of the representatives of the Underwriters for a period of 180 days from the date of this prospectus, subject to certain exceptions and automatic extension in certain circumstances. In addition, pursuant to the Registration Rights Agreement, we have granted certain shareholders the right to cause us, in certain instances, at our expense, to file registration statements under the Securities Act of 1933, as amended (the Securities Act) covering resales of our common stock held by them or to piggyback on a registration statement in certain circumstances. This right will not be exercisable during the 180 day restricted period described above. These shares will represent approximately % of our common stock after this offering or % if the underwriters exercise their option to purchase additional shares in full. These shares may also be sold pursuant to Rule 144 under the Securities Act, depending on their holding

period and subject to restrictions in the case of shares held by persons deemed to be our affiliates. As restrictions on resale tyle="line-height:120%;text-align:left;text-indent:24px;font-size:10pt;">At June 30, 2016 the Company had $17,838,000 in reserves for sales discounts compared to $15,094,000 at December 31, 2015 on products shipped to our customers under various promotional programs. The increase was primarily due to additional discounts reserved on the Company's agricultural products during the pre-season, which runs from August to December of each year and orders are shipped through the second quarter of 2017. The Company reviews the reserve quarterly based on analysis made on each program outstanding at the time.

The allowance for doubtful accounts was $3,550,000 at June 30, 2016 and $3,484,000 at December 31, 2015.

4. Inventories

Inventories valued at LIFO cost represented 47% and 45% of total inventory at June 30, 2016 and December 31, 2015, respectively. The excess of current cost over LIFO valued inventories was approximately $8,712,000 at June 30, 2016 and December 31, 2015. An actual valuation of inventory under the LIFO method is made only at the end of each year based on the inventory levels and costs at that time. Accordingly, interim LIFO must necessarily be based, to some extent, on management's estimates at each quarter end. Net inventories consist of the following:

(in thousands)	June 30, 2016	December 31, 2015
Finished goods	$ 132,363	$ 129,995
Work in process	14,756	9,561
Raw materials	12,721	11,202
Total inventory	$ 159,840	$ 150,758

Inventory obsolescence reserves were $7,581,000 at June 30, 2016 and $9,675,000 at December 31, 2015. The decrease in reserve for obsolescence resulted from the Company's write-off of previously reserved inventory.

5. Rental Equipment

Rental equipment is shown net of accumulated depreciation of $9,832,000 and $8,322,000 at June 30, 2016 and December 31, 2015, respectively. The Company recognized depreciation expense of $1,699,000 and $1,918,000 for the three months ended June 30, 2016 and June 30, 2015, respectively and $3,443,000 and $3,664,000 for the six months ended June 30, 2016 and June 30, 2015, respectively.

6. Fair Value Measurements

The carrying values of certain financial instruments, including cash and cash equivalents, accounts receivable, accounts payable, and accrued expenses, approximate their fair value because of the short-term nature of these items. The carrying value of our debt approximates the fair value as of June 30, 2016 and December 31, 2015, as the floating rates on our outstanding balances approximate current market rates. This conclusion was made based on Level 2 inputs.

7. Goodwill and Intangible Assets

The following is the summary of changes to the Company's Goodwill for the six months ended June 30, 2016:

(in thousands)	
Balance at December 31, 2015	$75,509
Goodwill acquired	—
Translation adjustments	410
Balance at June 30, 2016	$75,919

As of June 30, 2016, the Company had $75,919,000 of goodwill, which represents 12% of total assets.

The following is a summary of the Company's definite and indefinite-lived intangible assets net of the accumulated amortization:

(in thousands)	Estimated Useful Lives	June 30, 2016	December 31, 2015
Definite:			
Trade names and trademarks	25 years	$21,962	$ 21,878
Customer and dealer relationships	14 years	28,970	28,715
Patents and drawings	12 years	1,921	1,893
Total at cost		52,853	52,486
Less accumulated amortization		(6,629)	(5,036)
Total net		46,224	47,450
Indefinite:			
Trade names and trademarks		5,500	5,500
Total Intangible Assets		$51,724	$ 52,950

The Company recognized amortization expense of $777,000 and $782,000 for the three months ending June 30, 2016 and 2015, respectively and $1,549,000 and $1,563,000 for the six months ended June 30, 2016 and 2015, respectively.

As of June 30, 2016, the Company had $51,724,000 of intangible assets which represents 8% of total assets.

8. Warranty

Warranty reserve, as a percentage of sales, is generally calculated by looking at the current twelve months' expenses and prorating that amount based on twelve months' sales with a ninety-day to six-month lag period. The Company's historical experience is that an end-user takes approximately 90 days to six months from the receipt of

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the unit to file a warranty claim. A warranty reserve is established for each different marketing group. Reserve balances are evaluated on a quarterly basis and adjustments made when required.

The current liability warranty reserve balance was $5,133,000 at June 30, 2016 and $5,566,000 at December 31, 2015. The decrease was mainly from the Company's U.S. Operations.

9. Debt

The components of long-term debt are as follows:

(in thousands)	June 30, 2016	December 31, 2015
Current Maturities:		
Capital lease obligations	$9	$ 17
Other notes payable	1,202	60
	1,211	77
Long-term debt:		
Bank revolving credit facility	164,000	144,000
Capital lease obligations	3	6
	164,003	144,006
Total debt	$165,214	$ 144,083

As of June 30, 2016, $1,582,000 of the revolver capacity was committed to irrevocable standby letters of credit issued in the ordinary course of business as required by vendors' contracts, resulting in $84,418,000 in available borrowings. As of June 30, 2016, the Company was in compliance with the covenants under the Agreement.

10. Common Stock and Dividends

Dividends declared and paid on a per share basis were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Dividends declared	$0.09	$0.08	$0.18	$0.16
Dividends paid	$0.09	$0.08	$0.18	$0.16

On July 1, 2016, the Company announced that its Board of Directors had declared a quarterly cash dividend of $0.09 per share, which was paid on July 29, 2016, to shareholders of record at the close of business on July 15, 2016.

11. Stock-Based Compensation

The Company’s stock-based compensation expense was $439,000 and $290,000 for the three months ended June 30, 2016 and 2015, respectively and $724,000 and $466,000 for the six months ended June 30, 2016 and 2015, respectively.

The Company granted 21,000 Qualified Stock Options and 26,600 Restricted Stock Awards during the second quarter of 2016.

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12. Earnings Per Share

The following table sets forth the reconciliation from basic to diluted average common shares and the calculations of net income per common share. Net income for basic and diluted calculations do not differ.

(In thousands, except per share)	Three Months Ended June 30, 2016	2015	Six Months Ended June 30, 2016	2015
Net Income	$10,562	$9,710	$19,221	$17,069
Average Common Shares:				
Basic (weighted-average outstanding shares)	11,422	11,352	11,405	11,316
Dilutive potential common shares from stock options	128	146	124	151
Diluted (weighted-average outstanding shares)	11,550	11,498	11,529	11,467
Basic earnings per share	$0.93	$0.86	$1.69	$1.51
Diluted earnings per share	$0.92	$0.84	$1.67	$1.49

Stock options totaling 42,981 shares for the six months ended June 30, 2016 were not included in the diluted earnings per share calculation because the effect would have been anti-dilutive.

13. Segment Reporting

At June 30, 2016 the following includes a summary of the unaudited financial information by reporting segment:

(in thousands)	Three Months Ended June 30, 2016	2015	Six Months Ended June 30, 2016	2015
Net Sales				
Industrial	$117,146	$118,521	$240,424	$235,433
Agricultural	51,845	52,981	100,507	101,438
European	42,498	44,232	81,529	86,661
Consolidated	$211,489	$215,734	$422,460	$423,532
Income from Operations				
Industrial	$9,171	$10,100	$20,698	$19,437
Agricultural	6,048	3,722	8,807	4,514
European	2,822	2,613	4,825	4,612
Consolidated	$18,041	$16,435	$34,330	$28,563

(in thousands)	June 30, 2016	December 31, 2015
Goodwill		
Industrial	$56,660	$ 56,293
Agricultural	3,548	2,984
European	15,711	16,232
Consolidated	$75,919	$ 75,509
Total Identifiable Assets		
Industrial	$370,278	$ 370,642
Agricultural	132,894	110,489
European	142,156	122,372
Consolidated	$645,328	$ 603,503

14. Contingent Matters

Like other manufacturers, the Company is subject to a broad range of federal, state, local and foreign laws and requirements, including those concerning air emissions, discharges into waterways, and the generation, handling, storage, transportation, treatment and disposal of hazardous substances and waste materials, as well as the remediation of contamination associated with releases of hazardous substances at the Company's facilities and off-site disposal locations, workplace safety and equal employment opportunities. These laws and regulations are constantly changing, and it is impossible to predict with accuracy the effect that changes to such laws and regulations may have on the Company in the future. Like other industrial concerns, the Company's manufacturing operations entail the risk of noncompliance, and there can be no assurance that the Company will not incur material costs or other liabilities as a result thereof.

The Company knows that its Indianola, Iowa property is contaminated with chromium which most likely resulted from chrome plating operations which were discontinued before the Company purchased the property. Chlorinated volatile organic compounds have also been detected in water samples on the property, though the source is unknown at this time. The Company voluntarily worked with an environmental consultant and the state of Iowa with respect to these issues and believes it completed its remediation program in June 2006. The work was accomplished within the Company's environmental liability reserve balance. We requested a "no further action" classification from the state. We received a conditional "no further action" letter in January of 2009. When we demonstrate stable or improving conditions below residential standards for a certain period of time by monitoring existing wells, we will request an unconditional "no further action" letter.

Alamo Group Inc. and Bush Hog, Inc. were added as defendants in 2013 to litigation by Deere & Company as plaintiff against Bush Hog, LLC (now Duroc, LLC) and Great Plains Manufacturing Incorporated, in which Deere alleged infringement of a mower-related patent. The jury concluded that not only did the defendants not infringe the patent, but that the patent was invalid as well. The Company expensed $2,100,000 in legal fees related to this lawsuit in 2013. Deere & Company appealed and requested a new trial. A hearing on the appeal was held on October 8, 2015. On May 26, 2016 the Federal Circuit Court of Appeals affirmed the lower court ruling and validating the jury's finding that the defendants did not infringe the patent, and that the Deere & Company patent was invalid.

Certain assets of the Company contain asbestos that may have to be remediated over time. The Company believes that any subsequent change in the liability associated with the asbestos removal will not have a material adverse effect on the Company's consolidated financial position or results of operations.

The Company is subject to various other federal, state, and local laws affecting its business, as well as a variety of regulations relating to such matters as working conditions, equal employment opportunities, and product safety. A variety of state laws regulate the Company's contractual relationships with its dealers, some of which impose restrictive standards on the relationship between the Company and its dealers, including events of default, grounds for termination, non-renewal of dealer contracts, and equipment repurchase requirements. The Company believes it is currently in material compliance with all such applicable laws and regulations.

15. Retirement Benefit Plans

Defined Benefit Plan

The following tables present the components of net periodic benefit cost (gains are denoted with parentheses and losses are not):

	Six Months Ended June 30, 2016		
(in thousands)	Hourly Employees' Pension Plan	Employees' Retirement Plan	Total
Service cost	$4	$ 2	$6
Interest cost	200	444	644
Expected return on plan assets	(324)	(598)	(922)
Amortization of net loss	142	220	362
Net periodic benefit cost	$22	$ 68	$90

	Six Months Ended June 30, 2015		
(in thousands)	Hourly Employees' Pension Plan	Employees' Retirement Plan	Total
Service cost	$ 4	$ 2	$6
Interest cost	202	434	636
Expected return on plan assets	(330)	(614)	(944)
Amortization of net loss	124	200	324
Net periodic benefit cost	$ —	$ 22	$22

The Company amortizes annual pension expense evenly over four quarters. Pension expense was $45,000 and $11,000 the three months ended June 30, 2016 and June 30, 2015, respectively. Pension expense for the six months ended June 30, 2016 was $90,000 and $22,000 for the six month ending June 30, 2015. The Company is not required to contribute to the pension plans for the 2016 plan year but may do so.

On April 6, 2016 we notified all participants in the Gradall Company Hourly Employees' Pension Plan of our decision to terminate the plan. Participants in the plan will not lose any benefits but will be given a choice between obtaining certain continued annuity benefits that match the benefits offered under the plan or receiving an immediate one-time lump sum payment in total settlement of benefits. We must meet various legal requirements in connection with the proper termination of the plan, and as a result we do not expect termination of the plan to be completed until 2017.

Supplemental Retirement Plan

In May of 2015, the Board amended the SERP to allow the Board to modify the retirement benefit percentage either higher or lower than 20%. In May of 2016, the Board added additional highly compensated employees to the plan. As of June 30, 2016, the current retirement benefit (as defined in the plan) for the participants ranges from 10% and 20%.

The net period expense for the three months ended June 30, 2016 and 2015 was $148,000 and $150,000, respectively and $295,000 and $300,000 for the six months ended June 30, 2016 and 2015, respectively.

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Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

The following tables set forth, for the periods indicated, certain financial data:

As a Percent of Net Sales	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Industrial	55.4 %	54.9 %	56.9 %	55.6 %
Agricultural	24.5 %	24.6 %	23.8 %	23.9 %
European	20.1 %	20.5 %	19.3 %	20.5 %
Total sales, net	100.0%	100.0%	100.0%	100.0%

Cost Trends and Profit Margin, as Percentages of Net Sales	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Gross margin	24.7%	23.5%	24.3%	22.7%
Income from operations	8.5 %	7.6 %	8.1 %	6.7 %
Income before income taxes	8.0 %	7.0 %	7.4 %	6.3 %
Net income	5.0 %	4.5 %	4.5 %	4.0 %

Overview

This report contains forward-looking statements that are based on Alamo Group’s current expectations. Actual results in future periods may differ materially from those expressed or implied because of a number of risks and uncertainties which are discussed below and in the Forward-Looking Information section.

For the first six months of 2016, the Company's net income was up approximately 12.6% when compared to the same period in 2015. This increase was primarily the result of continued improvement in production efficiencies, lower material costs and control of operating expenses and to a lesser extent, improved sales in the Company's Industrial Division. Negatively influencing both our sales and profits was the effect of the currency translation rates on our non-U.S. results. Alamo's Industrial Division saw a 2.1% increase in sales for the first six months of 2016 as sales of mowing, excavator and sweeping equipment outperformed the same period in 2015, while sales of vacuum trucks declined during the first six months of 2016 compared to the same period in 2015. Agricultural sales were slightly down in 2016 compared to the first six months of 2015 as soft market conditions continue to affect the agricultural market. European sales for the first six months of 2016 were down in U.S. dollars by 5.9% but slightly ahead in local currency compared to the same period in 2015. Consolidated income from operations was up 20.2% in the first six months of 2016. The Company's backlog was $130 million at the end of the first six months of 2016, which was down 19.8% versus the backlog of $162 million at the end of the first six months of 2015. The decrease in the Company's backlog was primarily attributable to softness in the Industrial Division's vacuum truck orders from non-governmental end users, weak economic conditions and unfavorable foreign currency translation affecting new orders in the European Division, and to a lesser extent, high prior year backlogs of initial orders related to new product introductions.

The Company believes that its markets for the remainder of 2016 will be steady but they could be negatively affected by a variety of factors such as a continued weakness in the overall economy, sovereign debt issues, credit availability, changes in currency exchange rates, increased levels of government regulations; ongoing weakness in the agricultural sector; changes in farm incomes due to commodity prices or governmental aid programs; adverse situations that could affect our customers such as animal disease epidemics, extreme weather conditions; repercussions from the pending exit by the U.K. from the European Union (Brexit); budget constraints or revenue

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shortfalls in governmental entities and changes in our customers' buying habits due to lack of confidence in the economic outlook.

Results of Operations

Three Months Ended June 30, 2016 vs. Three Months Ended June 30, 2015

Net sales for the second quarter of 2016 were $211,489,000, a decrease of $4,245,000, or 2.0% compared to $215,734,000 for the second quarter of 2015. The decrease was mainly attributable to continued weakness in the European economy, soft agricultural markets and currency translation effects all of which continued to negatively impact our sales. In the Industrial Division, sales of sweepers, mowing equipment and snow removal equipment increased compared to the first quarter of 2015; however, sales were down in vacuum trucks due to soft non-governmental demands. Sales in the Agricultural Division were down slightly during the quarter as continued weakness in the agricultural market and low commodity prices impacted this Division. European sales were down 3.9% as currency translation rates negatively affected the sales of U.K. and European products.

Net Industrial sales decreased during the second quarter by $1,375,000 or 1.2% to $117,146,000 for 2016 compared to $118,521,000 during the same period in 2015. The decrease was due to softness in sales of vacuum trucks to non-governmental end users, offset by increases in sweepers, mowing equipment and snow removal equipment.

Net Agricultural sales were $51,845,000 in the second quarter of 2016 compared to $52,981,000 for the same period in 2015, a decrease of $1,136,000 or 2.1%. Weak agricultural market conditions and low commodity prices continued to negatively affect farm income which limited farmers' ability to purchase new equipment.

Net European Sales for the second quarter of 2016 were $42,498,000, a decrease of $1,734,000 or 3.9% compared to $44,232,000 during the second quarter of 2015. Half of the decrease resulted primarily from changes in currency translation rates which had a negative impact during the quarter. Industrial sales in France were up slightly compared to the second quarter of 2015 as a result of increased sales of Rivard vacuum trucks, however the French agricultural markets remained weak. U.K. sales were down in the second quarter of 2016 compared to the second quarter of 2015 as demand for mowing products were impacted by the uncertainty surrounding the recent Brexit vote in the U.K. and continued softness in agricultural markets we serve.

Gross profit for the second quarter of 2016 was $52,178,000 (24.7% of net sales) compared to $50,665,000 (23.5% of net sales) during the same period in 2015, an increase of $1,513,000. The increase in margin dollars during the second quarter of 2016 was due to continuous improvement in production efficiencies as well as lower material costs. Negatively impacting the gross margin and margin percent during the second quarter of 2015 was $775,000 in higher cost of goods sold related to the step-up in fair value of inventory in the Specialized business units.

Selling, general and administrative expenses (“SG&A”) were $34,137,000 (16.1% of net sales) during the second quarter of 2016 compared to $34,230,000 (15.9% of net sales) during the same period of 2015, a decrease of $93,000.

Interest expense was $1,523,000 for the second quarter of 2016 compared to $1,848,000 during the same period in 2015, a decrease of $325,000. The decrease in 2016 came from lower borrowings during the second quarter of 2016 compared to the second quarter of 2015.

Other income (expense), net was $242,000 of income for the second quarter of 2016 compared to $488,000 of income during the same period in 2015. The income in 2016 and 2015 were primarily the result of changes in exchange rates.

Provision for income taxes was $6,254,000 (37.2%) in the second quarter of 2016 compared to $5,406,000 (35.8%) during the same period in 2015. The increase in taxes is from higher profits in 2016. The higher effective tax rate in 2016 is primarily related to a higher portion of our taxable income being generated in jurisdictions with higher tax rates.

The Company’s net income after tax was $10,562,000 or $0.92 per share on a diluted basis for the second quarter of 2016 compared to $9,710,000 or $0.84 per share on a diluted basis for the second quarter of 2015. The increase of $852,000 resulted from the factors described above.

Six Months Ended June 30, 2016 vs. Six Months Ended June 30, 2015

Net sales for the first six months of 2016 were $422,460,000, a decrease of $1,072,000 or 0.3% compared to $423,532,000 for the first six months of 2015. The decrease was primarily from currency translation effects. In the Industrial Division, excavators, sweepers, mowing equipment and to a lesser extent, snow removal products were up in the first six months of 2016 compared to the first six months of 2015, however sales of vacuum trucks specifically to non-governmental end users were down due to soft market conditions. Agricultural Division sales were down less than 1% for the first six months of 2016 due to a continued weak agricultural market compared to the same period in 2015. Sales in the European Division were down 5.9% as sales of UK and European products were negatively affected by currency translation rates and soft market conditions due to the uncertainty created by the recent Brexit vote in the U.K.

Net Industrial sales increased during the first six months by $4,991,000 or 2.1% to $240,424,000 for 2016 compared to $235,433,000 during the same period in 2015. The increase came primarily from the increased sales from sweeper, excavator, mowing equipment and snow removal equipment product lines. Negatively affecting sales were lower vacuum trucks sales to non-governmental end users.

Net Agricultural sales were $100,507,000 during the first six months of 2016 compared to $101,438,000 for the same period in 2015, a decrease of $931,000 or 0.9%. The decrease in sales for the first six months of 2016 compared to the first six months of 2015 was from the continued softness in the overall agricultural market.

Net European sales for the first six months of 2016 were $81,529,000, a decrease of $5,132,000 or 5.9% compared to $86,661,000 during the same period of 2015. The decrease in 2016 was primarily due to the negative affect from currency translation rates. The European Division continued to be faced with challenging market conditions particularly in France as agricultural markets were constrained by Europe's overall economic uncertainty. Rivard vacuum and sweeper equipment had increased sales compared to the first six months of 2015.

Gross profit for the first six months of 2016 was $102,455,000 (24.3% of net sales) compared to $96,202,000 (22.7% of net sales) during the same period in 2015, an increase of $6,253,000. The increase in margin dollars was mainly due to continuous improvement in production efficiencies as well as lower material costs. Negatively affecting both the gross margin and margin percent during the first six months of 2015 was $2,530,000 in higher cost of goods sold related to the step-up in fair value of inventory in the Specialized business units.

Selling, general and administrative expenses (“SG&A”) were $68,125,000 (16.1% of net sales) during the first six months of 2016 compared to $67,639,000 (16.0% of net sales) during the same period of 2015, an increase of $486,000. The increase in SG&A for the first six months of 2016 was primarily the result of increased sales commissions and marketing promotion expenses during the first quarter of 2016.

Interest expense was $2,929,000 for the first six months of 2016 compared to $3,471,000 during the same period in 2015, a decrease of $542,000. The decrease in 2016 came from the Company's efforts to reduce our borrowings which resulted in lower interest costs.

Other income (expense), net was $380,000 of expense during the first six months of 2016 compared to $1,348,000 of income in the first six months of 2015. The expense in 2016 and income in 2015 were primarily the result of changes in exchange rates.

Provision for income taxes was $11,918,000 (38.3%) in the first six months of 2016 compared to $9,464,000 (35.7%) during the same period in 2015. The increased effective tax rate in 2016 is primarily due to a higher portion of our taxable income being generated in jurisdictions with higher tax rates as well as losses incurred in certain foreign jurisdictions that did not result in a tax benefit.

The Company's net income after tax was $19,221,000 or $1.67 per share on a diluted basis for the first six months of 2016 compared to $17,069,000 or $1.49 per share on a diluted basis for the first six months of 2015. The increase of $2,152,000 resulted from the factors described above.

Liquidity and Capital Resources

In addition to normal operating expenses, the Company has ongoing cash requirements which are necessary to operate the Company's business, including inventory purchases and capital expenditures. The Company's inventory and accounts payable levels typically build in the first half of the year and in the fourth quarter in anticipation of the spring and fall selling seasons. Accounts receivable historically build in the first and fourth quarters of each year as a result of fall preseason sales programs and out of season sales, particularly in our Agricultural Division. Preseason sales, primarily in the Agricultural Division, help level the Company's production during the off season.

As of June 30, 2016, the Company had working capital of $317,119,000 which represents an increase of $39,257,000 from working capital of $277,862,000 of December 31, 2015.

Capital expenditures were $6,191,000 for the first six months of 2016, compared to $5,101,000 during the first six months of 2015. The Company expects to fund future expenditures from operating cash flows or through its revolving credit facility, described below.

Net cash provided by financing activities was $19,977,000 and $13,151,000 during the six month periods ended June 30, 2016 and June 30, 2015, respectively. The increase in net cash provided by financing activities in 2016 resulted from increased borrowings under our bank credit facility due to seasonal funding of operations.

The Company had $42,428,000 in cash and cash equivalents held by its foreign subsidiaries as of June 30, 2016. The majority of these funds are at our U.K. and Canadian subsidiaries and would not be available for use in the United States without incurring US federal and state tax consequences. The Company plans to use these funds for capital expenditures or acquisitions outside the United States.

The Company maintains an unsecured revolving credit facility with certain lenders under its Amended and Restated Revolving Credit Agreement ("the Agreement"). The aggregate commitments from lenders under the Agreement is $250,000,000 and, subject to certain conditions, the Company has the option to request an increase in aggregate commitments of up to an additional $50,000,000. The Agreement requires the Company to maintain various financial covenants including a minimum earnings before interest and tax to interest expense ratio, a maximum leverage ratio and a minimum asset coverage ratio. The Agreement also contains various covenants relating to limitations on indebtedness, limitations on investments and acquisitions, limitations on sale of properties and limitations on liens and capital expenditures. The Agreement also contains other customary covenants, representations and events of defaults. The termination date of the Agreement is May 12, 2019. As of June 30, 2016, $164,000,000 was outstanding under the Agreement. On June 30, 2016, $1,582,000 of the revolver capacity was committed to irrevocable standby letters of credit issued in the ordinary course of business as required by vendors' contracts resulting in $84,418,000 in available borrowings. As of June 30, 2016, the Company was in compliance with the covenants under the Agreement.

Management believes the bank credit facility and the Company's ability to internally generate funds from operations should be sufficient to meet the Company's cash requirements for the foreseeable future. However, the challenges affecting the banking industry and credit markets in general could potentially cause changes to credit availability, which creates a level of uncertainty.

Critical Accounting Estimates

Management’s Discussion and Analysis of Financial Condition and Results of Operations are based upon our Consolidated Financial Statements, which have been prepared in accordance with GAAP. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and liabilities. Management bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Critical Accounting Policies

An accounting policy is deemed to be critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time the estimate is made, and if different estimates that reasonably could have been used, or changes in the accounting estimates that are reasonably likely to occur periodically, could materially impact the financial statements. Management believes that of the Company's significant accounting policies, which are set forth in Note 1 of the Notes to Consolidated Financial Statements in the Company's 2015 10-K, the policies relating to the business combinations, allowance for doubtful accounts, sales discounts, inventories-obsolete and slow moving, warranty, and goodwill and other intangible assets involved a higher degree of judgment and complexity. There have been no material changes to the nature of estimates, assumptions and levels of subjectivity and judgment related to critical accounting estimates disclosed in Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations" of the Company's 2015 10-K.

Off-Balance Sheet Arrangements

There are currently no off-balance sheet arrangements that have or are currently likely to have a current or future material effect on our financial condition.

Forward-Looking Information

Part I of this Quarterly Report on Form 10-Q and the “Management’s Discussion and Analysis of Financial Condition and Results of Operations” included in Item II of this Quarterly Report contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. In addition, forward-looking statements may be made orally or in press releases, conferences, reports or otherwise, in the future by or on behalf of the Company.

Statements that are not historical are forward-looking. When used by or on behalf of the Company, the words “estimate,” “believe,” “intend”, "will", "would", "should", "could" and similar expressions generally identify forward-looking statements made by or on behalf of the Company.

Forward-looking statements involve risks and uncertainties. These uncertainties include factors that affect all businesses operating in a global market, as well as matters specific to the Company and the markets it serves. Particular risks and uncertainties facing the Company include changes in market conditions; ongoing weakness in the agricultural sector; a strong U.S. dollar; increased competition; decreases in the prices of agricultural commodities, which could affect our customers' income levels; repercussions from the exit by the U.K. from the European Union; budget constraints or income shortfalls which could affect the purchases of our type of equipment by governmental customers; credit availability for both the Company and its customers, adverse weather conditions such as droughts, floods, snowstorms, etc. which can affect buying patterns of the Company’s customers and related contractors; the

price and availability of critical raw materials, particularly steel and steel products; energy cost; increased cost of new governmental regulations which effect corporations; the potential effects on the buying habits of our customers due to animal disease outbreaks such as mad cow and other epidemics; the Company’s ability to develop and manufacture new and existing products profitably; market acceptance of new and existing products; the Company’s ability to maintain good relations with its employees; the Company's ability to successfully complete acquisitions and operate acquired businesses or assets; and the ability to hire and retain quality employees.

In addition, the Company is subject to risks and uncertainties facing the industry in general, including changes in business and political conditions and the economy in general in both domestic and international markets; weather conditions affecting demand; slower growth in the Company's markets; financial market changes including increases in interest rates and fluctuations in foreign exchange rates; actions of competitors; the inability of the Company's suppliers, customers, creditors, public utility providers and financial service organizations to deliver or provide their products or services to the Company; seasonal factors in the Company's industry; litigation; government actions including budget levels, regulations and legislation, primarily relating to the environment, commerce, infrastructure spending, health and safety; and availability of materials.

The Company wishes to caution readers not to place undue reliance on any forward-looking statements and to recognize that the statements are not predictions of actual future results. Actual results could differ materially from those anticipated in the forward-looking statements and from historical results, due to the risks and uncertainties described above, as well as others not now anticipated. The foregoing statements are not exclusive and further information concerning the Company and its businesses, including factors that could potentially materially affect the Company's financial results, may emerge from time to time. It is not possible for management to predict all risk factors or to assess the impact of such risk factors on the Company's businesses.

Item 3. Quantitative and Qualitative Disclosures About Market Risks

The Company is exposed to various market risks. Market risks are the potential losses arising from adverse changes in market prices and rates. The Company does not enter into derivative or other financial instruments for trading or speculative purposes.

Foreign Currency Risk

International Sales

A portion of the Company's operations consists of manufacturing and sales activities in international jurisdictions. The Company primarily manufactures its products in the U.S., U.K., France, Canada and Australia. The Company sells its products primarily in the functional currency within the markets where the products are produced, but certain sales from the Company's U.K. and Canadian operations are denominated in other foreign currencies. As a result, the Company's financials, specifically the value of its foreign assets, could be affected by factors such as changes in foreign currency exchange rates or weak economic conditions in the other markets in which the subsidiaries of the Company distribute their products.

To mitigate the short-term effect of changes in currency exchange rates on the Company's functional currency-based sales, the Company's U.K. subsidiaries regularly enter into foreign exchange forward contracts to hedge approximately 90% of its future net foreign currency collections over a period of six months. As of June 30, 2016, the Company had $2,314,000 outstanding in forward exchange contracts related to accounts receivable. A 15% fluctuation in exchange rates for these currencies would change the fair value of these contracts by approximately $347,000. However, since these contracts hedge foreign currency denominated transactions, any change in the fair value of the contracts should be offset by changes in the underlying value of the transaction being hedged.

Exposure to Exchange Rates

The Company translates the assets and liabilities of foreign-owned subsidiaries at rates in effect at the balance sheet date. Revenues and expenses are translated at average rates in effect during the reporting period. Translation adjustments are included in accumulated other comprehensive income within the statement of stockholders' equity. The total foreign currency translation adjustment for the current quarter decreased stockholders' equity by $7,140,000.

The Company’s earnings are affected by fluctuations in the value of the U.S. dollar as compared to foreign currencies, predominately in European countries, as a result of the sales of its products in international markets. Forward currency contracts are used to hedge against the earnings effects of such fluctuations. The result of a uniform 10% strengthening in the value of the dollar relative to the currencies in which the Company’s sales are denominated would result in a decrease in gross profit of $2,724,000 for the six month period ending June 30, 2016. Comparatively, the result of a uniform 10% strengthening in the value of the dollar relative to the currencies in which the Company’s sales are denominated would have resulted in a decrease in gross profit of approximately $2,577,000 for the six month period ended June 30, 2015. This calculation assumes that each exchange rate

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would change in the same direction relative to the U.S. dollar. In addition to the direct effects of changes in exchange rates, which include a changed dollar value of the resulting sales, changes in exchange rates may also affect the volume of sales or the foreign currency sales price as competitors' products become more or less attractive. The Company's sensitivity analysis of the effects of changes in foreign currency exchange rates does not factor in a potential change in sales levels or local currency prices.

Interest Rate Risk

The Company's long-term debt bears interest at variable rates. Accordingly, the Company's net income is affected by changes in interest rates. Assuming the current level of borrowings at variable rates and a two percentage point change for the second quarter 2016 average interest rate under these borrowings, the Company's interest expense would have changed by approximately $820,000. In the event of an adverse change in interest rates, management could take actions to mitigate its exposure. However, due to the uncertainty of the actions that would be taken and their possible effects this analysis assumes no such actions. Further this analysis does not consider the effects of the change in the level of overall economic activity that could exist in such an environment.

Item 4. Controls and Procedures

Disclosure Controls and Procedures.

An evaluation was carried out under the supervision and with the participation of Alamo's management, including our President and Chief Executive Officer, Executive Vice President and Chief Financial Officer (Principal Financial Officer) and Vice-President and Corporate Controller, (Principal Accounting Officer), of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13A-15(e) under the Securities Exchange Act of 1933). Based upon the evaluation, the President and Chief Executive Officer, Executive Vice President and Chief Financial Officer (Principal Financial Officer) and Vice-President, Corporate Controller, (Principal Accounting Officer) concluded that the Company's design and operation of these disclosure controls and procedures were effective at the end of the period covered by this report.

Changes in internal control over financial reporting

There has been no change in our internal control over financial reporting that occurred during our last fiscal year that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. - Legal Proceedings

For a description of legal proceedings, see Note 14 Contingent Matters to our interim condensed consolidated financial statements.

Item 1A. - Risk Factors

The United Kingdom's impending departure from the European Union could materially and adversely affect us.

On June 23, 2016, the U.K. held a referendum in which a majority of voters voted to exit from the European Union (E.U.), commonly referred to as "Brexit". As a result of the referendum, it is expected that the U.K. government will begin negotiating the terms of the U.K.'s exit from, and future relationship with, the E.U. Although it is unknown what the terms of exit from the E.U. or any future trade agreements will be, it is possible that there will be greater restrictions on imports and exports between the U.K., on the one hand, and E.U. and other countries, on the other hand, and increased regulatory complexities. The effects of Brexit will depend, among other things, on any agreements the U.K. makes to retain access to European Union and other markets either during a transitional period or more permanently. Brexit could adversely affect European and worldwide economic and market conditions and could contribute to instability in global financial and foreign exchange markets, including volatility in the value of the sterling and euro. In addition, Brexit could lead to legal uncertainty and potentially divergent national laws and regulations as the U.K. determines which E.U. laws to replace or replicate. Any of these effects of Brexit, and others we cannot anticipate, could materially and adversely affect our operations and financial results.

Other than as set forth under this Item 1A, there have not been any material changes from the risk factors previously disclosed in our annual report on Form 10-K for the year ended December 31, 2015.

Item 2. - None

Item 3. - None

Item 4. - None

Item 5. - Other Information

(a) Reports on Form 8-K

None

(b) Other Information

None

Item 6. - Exhibits

(a) Exhibits

3.1		Certificate of Incorporation of Alamo Group Inc.	Incorporated herein by reference to Exhibit 3.1 to Form S-1 Filed on February 5, 1993
3.2		Certificate of Amendment to Certificate of Incorporation of Alamo Group Inc.	Incorporated herein by reference to Exhibit 3.1 to Form 8-K Filed on May 10, 2016
3.3		By-Laws, Amended as of May 5, 2016, of Alamo Group Inc.	Incorporated herein by reference to Exhibit 3.2 to Form 8-K Filed on May 10, 2016
31.1	—	Certification by Ronald A. Robinson under Section 302 of the Sarbanes-Oxley Act of 2002	Filed Herewith
31.2	—	Certification by Dan E. Malone under Section 302 of the Sarbanes-Oxley Act of 2002	Filed Herewith
31.3	—	Certification by Richard J. Wehrle under Section 302 of the Sarbanes-Oxley Act of 2002	Filed Herewith
32.1	—	Certification by Ronald A. Robinson under Section 906 of the Sarbanes-Oxley Act of 2002	Filed Herewith
32.2	—	Certification by Dan E. Malone under Section 906 of the Sarbanes-Oxley Act of 2002	Filed Herewith
32.3	—	Certification by Richard J. Wehrle under Section 906 of the Sarbanes-Oxley Act of 2002	Filed Herewith
101.INS	—	XBRL Instance Document	Filed Herewith
101.SCH	—	XBRL Taxonomy Extension Schema Document	Filed Herewith
101.CAL	—	XBRL Taxonomy Extension Calculation Linkbase Document	Filed Herewith
101.DEF	—	XBRL Taxonomy Extension Definition Linkbase Document	Filed Herewith
101.LAB	—	XBRL Taxonomy Extension Label Linkbase Document	Filed Herewith
101.PRE	—	XBRL Taxonomy Extension Presentation Linkbase Document	Filed Herewith

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Alamo Group Inc. and Subsidiaries

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

August 5, 2016 Alamo Group Inc.
(Registrant)

/s/ Ronald A. Robinson
Ronald A. Robinson
President & Chief Executive Officer

/s/ Dan E. Malone
Dan E. Malone
Executive Vice President & Chief Financial Officer
(Principal Financial Officer)

/s/ Richard J. Wehrle
Richard J. Wehrle
Vice President & Corporate Controller
(Principal Accounting Officer)