

OFFICE DEPOT INC  
Form 10-Q  
July 28, 2006

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

(Mark One)

**Quarterly Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934**  
For the quarterly period ended July 1, 2006

or

**Transition Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934**  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-10948

**Office Depot, Inc.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**59-2663954**

(I.R.S. Employer  
Identification No.)

**2200 Old Germantown Road; Delray Beach, Florida**

(Address of principal executive offices)

**33445**

(Zip Code)

**(561) 438-4800**

(Registrant's telephone number, including area code)

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

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

Yes  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

The number of shares outstanding of the registrant's common stock, as of the latest practicable date: At July 1, 2006 there were 283,276,969 outstanding shares of Office Depot, Inc. Common Stock, \$0.01 par value.

**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements**

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

|  | <b>As of<br/>July 1,<br/>2006</b> | <b>As of<br/>December 31,<br/>2005</b> |
|--|-----------------------------------|--|
| <b>Assets</b>  |                                   |  |
| Current assets:  |                                   |  |
| Cash and cash equivalents  | \$ 341,350                        | \$ 703,197                             |
| Short-term investments   |                                   | 200                                    |
| Receivables, net   | 1,314,333                         | 1,232,107                              |
| Inventories, net   | 1,450,440                         | 1,360,274                              |
| Deferred income taxes  | 121,750                           | 136,998                                |
| Prepaid expenses and other current assets  | 116,749                           | 97,286                                 |
| Total current assets   | 3,344,622                         | 3,530,062                              |
| Property and equipment, net  | 1,326,128                         | 1,311,737                              |
| Goodwill   | 1,091,427                         | 881,182                                |
| Other assets   | 445,508                           | 375,544                                |
| Total assets   | \$ 6,207,685                      | \$ 6,098,525                           |
| <b>Liabilities and stockholders equity</b>   |                                   |  |
| Current liabilities:   |                                   |  |
| Trade accounts payable   | \$ 1,477,506                      | \$ 1,324,198                           |
| Accrued expenses and other current liabilities   | 1,068,020                         | 979,796                                |
| Income taxes payable   | 117,774                           | 117,487                                |
| Short-term borrowings and current maturities of long-term debt   | 34,114                            | 47,270                                 |
| Total current liabilities  | 2,697,414                         | 2,468,751                              |
| Deferred income taxes and other long-term liabilities  | 368,170                           | 321,455                                |
| Long-term debt, net of current maturities  | 581,761                           | 569,098                                |
| Minority interest  | 10,270                            |  |
| Commitments and contingencies  |                                   |  |
| Stockholders equity:   |                                   |  |
| Common stock authorized 800,000,000 shares of \$.01 par value; issued and outstanding shares - 425,075,847 in 2006 and 419,812,671 in 2005 | 4,251                             | 4,198                                  |
| Additional paid-in capital   | 1,652,554                         | 1,517,373                              |

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|   |              |              |
|---|--------------|--------------|
| Accumulated other comprehensive income  | 249,752      | 140,745      |
| Retained earnings   | 3,114,903    | 2,867,067    |
| Treasury stock, at cost 141,798,878 shares in 2006 and 122,787,210 shares in 2005 | (2,471,390)  | (1,790,162)  |
| Total stockholders' equity  | 2,550,070    | 2,739,221    |
| Total liabilities and stockholders' equity  | \$ 6,207,685 | \$ 6,098,525 |

*This report should be read in conjunction with the Notes to Condensed Consolidated Financial Statements ( Notes ) herein and the Notes to Consolidated Financial Statements in the Office Depot, Inc. Form 10-K filed February 15, 2006 (the 2005 Form 10-K ).*

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

|   | 13 Weeks Ended  |                  | 26 Weeks Ended  |                  |
|---|-----------------|------------------|-----------------|------------------|
|   | July 1,<br>2006 | June 25,<br>2005 | July 1,<br>2006 | June 25,<br>2005 |
| Sales   | \$ 3,494,907    | \$ 3,364,052     | \$ 7,310,607    | \$ 7,066,943     |
| Cost of goods sold and occupancy costs                | 2,416,665       | 2,327,805        | 5,030,459       | 4,879,041        |
| Gross profit  | 1,078,242       | 1,036,247        | 2,280,148       | 2,187,902        |
| Store and warehouse operating and selling expenses    | 756,505         | 740,345          | 1,600,026       | 1,568,152        |
| General and administrative expenses                   | 150,324         | 153,390          | 316,877         | 312,298          |
| Operating profit                                      | 171,413         | 142,512          | 363,245         | 307,452          |
| Other income (expense):                               |                 |                  |                 |                  |
| Interest income                                       | 1,086           | 5,761            | 7,345           | 11,230           |
| Interest expense                                      | (11,347)        | (15,179)         | (22,413)        | (25,562)         |
| Miscellaneous income, net                             | 6,625           | 7,691            | 14,089          | 12,391           |
| Earnings before income taxes                          | 167,777         | 140,785          | 362,266         | 305,511          |
| Income taxes  | 49,471          | 40,686           | 114,430         | 90,104           |
| Net earnings  | \$ 118,306      | \$ 100,099       | \$ 247,836      | \$ 215,407       |
| Earnings per common share:                            |                 |                  |                 |                  |
| Basic   | \$ 0.42         | \$ 0.32          | \$ 0.87         | \$ 0.69          |
| Diluted   | 0.41            | 0.31             | 0.85            | 0.68             |
| Weighted average number of common shares outstanding: |                 |                  |                 |                  |
| Basic   | 280,726         | 314,216          | 286,139         | 313,078          |
| Diluted   | 287,326         | 318,938          | 292,832         | 317,232          |

*This report should be read in conjunction with the Notes herein and the Notes to Consolidated Financial Statements in the 2005 Form 10-K.*

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

|   | <b>26 Weeks Ended</b>   |                          |
|---|-------------------------|--------------------------|
|   | <b>July 1,<br/>2006</b> | <b>June 25,<br/>2005</b> |
| <b>Cash flow from operating activities:</b>   |                         |                          |
| Net earnings  | \$ 247,836              | \$ 215,407               |
| Adjustments to reconcile net earnings to net cash provided by operating activities:           |                         |                          |
| Depreciation and amortization   | 137,373                 | 135,483                  |
| Charges for losses on inventories and receivables   | 42,716                  | 39,411                   |
| Changes in working capital and other  | 55,863                  | (303,919)                |
| Net cash provided by operating activities   | 483,788                 | 86,382                   |
| <b>Cash flows from investing activities:</b>  |                         |                          |
| Capital expenditures  | (121,489)               | (155,081)                |
| Acquisitions, net of cash acquired  | (176,022)               |                          |
| Proceeds from disposition of assets   | 21,042                  | 36,920                   |
| Purchase of short-term investments  | (961,450)               | (590,675)                |
| Sale of short-term investments  | 961,650                 | 533,822                  |
| Net cash used in investing activities   | (276,269)               | (175,014)                |
| <b>Cash flows from financing activities:</b>  |                         |                          |
| Proceeds from exercise of stock options and sale of stock under employee stock purchase plans | 82,111                  | 79,607                   |
| Tax benefits from employee share-based payments   | 32,502                  |                          |
| Acquisition of treasury stock   | (670,222)               | (90,574)                 |
| Net payments on long- and short-term borrowings   | (22,651)                | (32,813)                 |
| Net cash used in financing activities   | (578,260)               | (43,780)                 |
| <b>Effect of exchange rate changes on cash and cash equivalents</b>                           | <b>8,894</b>            | <b>(33,256)</b>          |
| Net decrease in cash and cash equivalents   | (361,847)               | (165,668)                |
| Cash and cash equivalents at beginning of period  | 703,197                 | 793,727                  |
| Cash and cash equivalents at end of period  | \$ 341,350              | \$ 628,059               |

*This report should be read in conjunction with the Notes herein and the Notes to Consolidated Financial Statements in the 2005 Form 10-K.*



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

**Note A Basis of Presentation**

Office Depot, Inc., including consolidated subsidiaries, is a global supplier of office products and services. Fiscal years are based on a 52- or 53-week period ending on the last Saturday in December. The condensed consolidated balance sheet at December 31, 2005 has been derived from audited financial statements at that date. The condensed interim financial statements as of July 1, 2006 and for the 13-week and 26-week periods ending July 1, 2006 (also referred to as the second quarter of 2006 and the first half of 2006 ) and June 25, 2005 (also referred to as the second quarter of 2005 and the first half of 2005 ) are unaudited. However, in our opinion, these financial statements reflect all adjustments (consisting only of normal, recurring items) necessary to provide a fair presentation of our financial position, results of operations and cash flows for the periods presented. In addition to the normal, recurring items recorded for fair interim financial statement presentation, we recognized expenses associated with exit and other activities because the related accounting criteria were met during the period. Certain prior period amounts have been reclassified to conform to current year presentation.

These interim results are not necessarily indicative of the results that should be expected for the full year. For a better understanding of Office Depot, Inc. and its financial statements, we recommend reading these condensed interim financial statements in conjunction with the audited financial statements for the year ended December 31, 2005, which are included in our 2005 Annual Report on Form 10-K, filed with the Securities and Exchange Commission ( SEC ).

**New Accounting Pronouncement**

In July 2006, the Financial Accounting Standards Board issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*. This Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The Interpretation is effective for fiscal years beginning after December 15, 2006. We have not yet analyzed the impact this Interpretation will have on our financial condition, results of operations, cash flows or disclosures.

**Note B Acquisitions**

During the second quarter of 2006, we completed the acquisitions of Allied Office Products in North America and Best Office in South Korea. We also increased our ownership interest to a majority stake in Office Depot Israel, an investment previously accounted for under the equity method. Allied Office Products is included in our North American Business Solutions Division and Best Office and Office Depot Israel are included in our International Division. Minority interest has been reflected for the equity portion we do not own. The cost of these acquisitions, net of cash acquired, was approximately \$176 million. The consideration has been allocated to acquired working capital and other accounts with approximately \$160 million initially allocated to goodwill. Both our integration plans and our assessment of the value of assets and liabilities acquired are in the process of being finalized. Accordingly, the amount initially allocated to goodwill likely will change as the integration and valuation processes are completed and amounts of separately identifiable intangible assets are recorded. One acquisition includes provisions that may result in payments to the former owners based on certain measures of future profitability that may impact goodwill in future periods. Additionally, Office Depot has the right to acquire or may be required to purchase some or all of the minority interest shares at various points over the next five years. Pro forma information relating to these acquisitions is not considered material.



**Note C Accounting for Stock-Based Compensation**

We adopted Statement of Financial Accounting Standards No. 123 (R) ( FAS 123R ), *Share-Based Payment*, at the beginning of the third quarter of 2005 using the modified prospective method. Accordingly, financial information for prior periods has not been restated. However, the pro forma effects of recognizing the estimated fair value of stock-based compensation for the second quarter and first half of 2005 have been disclosed previously in our footnotes under provisions of Statement of Financial Accounting Standards No. 123 ( FAS 123 ), *Accounting for Stock-Based Compensation*. The previously-disclosed pro forma information is presented below.

| <i>(In thousands, except per share amounts)</i>   | <b>Second<br/>Quarter<br/>2005</b> | <b>First<br/>Half<br/>2005</b> |
|---|------------------------------------|--------------------------------|
| Net earnings as reported  | \$ 100,099                         | \$ 215,407                     |
| Stock-based employee compensation cost included in net earnings as reported, net of tax | 3,492                              | 5,240                          |
| Compensation expense under FAS 123, net of tax  | (5,410)                            | (8,475)                        |
| Pro forma net earnings  | \$ 98,181                          | \$ 212,172                     |
| Net earnings per share Basic  |                                    |                                |
| As reported   | \$ 0.32                            | \$ 0.69                        |
| Pro forma   | 0.31                               | 0.68                           |
| Net earnings per share Diluted  |                                    |                                |
| As reported   | \$ 0.31                            | \$ 0.68                        |
| Pro forma   | 0.31                               | 0.67                           |

In addition to requiring companies to recognize the estimated fair value of share-based payments in earnings, FAS 123R modified the presentation of tax benefits received in excess of amounts determined based on the compensation expense recognized. Previously, such amounts were considered sources of cash in the operating activities section of the statement of cash flows. For periods after adopting FAS 123R under the modified prospective method, such benefits are presented as a source of cash in the financing activities section of the statement of cash flows.

**Note D Comprehensive Income**

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

| <i>(In thousands)</i>                         | <b>Second Quarter</b> |             | <b>First Half</b> |             |
|---|-----------------------|-------------|-------------------|-------------|
|   | <b>2006</b>           | <b>2005</b> | <b>2006</b>       | <b>2005</b> |
| Net earnings                                  | \$ 118,306            | \$ 100,099  | \$ 247,836        | \$ 215,407  |
| Other comprehensive income:                   |                       |             |                   |             |
| Foreign currency translation adjustments, net | 83,297                | (95,655)    | 108,806           | (167,729)   |
| Amortization of gain on cash flow hedge       | (415)                 | (414)       | (829)             | (829)       |
| Unrealized gain on cash flow hedge            | 823                   |             | 1,030             |             |
| Total comprehensive income                    | \$ 202,011            | \$ 4,030    | \$ 356,843        | \$ 46,849   |

**Note E Earnings Per Share ( EPS )**

The information required to compute basic and diluted EPS is as follows:

*(In thousands, except per share amounts)*

|   | Second Quarter |            | First Half |            |
|---|----------------|------------|------------|------------|
|   | 2006           | 2005       | 2006       | 2005       |
| Numerator:  |                |            |            |            |
| Net earnings  | \$ 118,306     | \$ 100,099 | \$ 247,836 | \$ 215,407 |
| Denominator:  |                |            |            |            |
| Weighted average shares outstanding:                  |                |            |            |            |
| Basic   | 280,726        | 314,216    | 286,139    | 313,078    |
| Effect of dilutive stock options and restricted stock | 6,600          | 4,722      | 6,693      | 4,154      |
| Diluted   | 287,326        | 318,938    | 292,832    | 317,232    |
| EPS:  |                |            |            |            |
| Basic   | \$ 0.42        | \$ 0.32    | \$ 0.87    | \$ 0.69    |
| Diluted   | 0.41           | 0.31       | 0.85       | 0.68       |

A portion of the 2005 long-term incentive awards to employees includes approximately one million shares of performance-based restricted stock that are not included in the weighted average share calculation until the underlying performance measures are met. Options to purchase approximately 3.5 million shares of common stock were not included in our computation of diluted earnings per share for the second quarter of 2005 because their weighted average effect would have been anti-dilutive.

**Note F Division Information**

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

*(In thousands)*

|  | Sales          |              |              |              |
|--|----------------|--------------|--------------|--------------|
|  | Second Quarter |              | First Half   |              |
|  | 2006           | 2005         | 2006         | 2005         |
| North American Retail Division             | \$ 1,507,612   | \$ 1,451,123 | \$ 3,298,340 | \$ 3,149,353 |
| North American Business Solutions Division | 1,128,676      | 1,065,909    | 2,258,673    | 2,116,859    |
| International Division                     | 858,619        | 847,775      | 1,753,594    | 1,802,116    |
| Total reportable segments                  | 3,494,907      | 3,364,807    | 7,310,607    | 7,068,328    |
| Eliminations                               |                | (755)        |              | (1,385)      |
| Total                                      | \$ 3,494,907   | \$ 3,364,052 | \$ 7,310,607 | \$ 7,066,943 |

*(In thousands)*

|  | Division Operating Profit |           |            |            |
|--|---------------------------|-----------|------------|------------|
|  | Second Quarter            |           | First Half |            |
|  | 2006                      | 2005      | 2006       | 2005       |
| North American Retail Division             | \$ 95,897                 | \$ 76,224 | \$ 229,659 | \$ 183,093 |
| North American Business Solutions Division | 100,842                   | 86,761    | 193,326    | 160,968    |
| International Division                     | 45,541                    | 51,153    | 98,520     | 108,805    |
| Total reportable segments                  | 242,280                   | 214,138   | 521,505    | 452,866    |

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|              |            |            |            |            |
|--------------|------------|------------|------------|------------|
| Eliminations | (27)       | (33)       | (154)      | (77)       |
| Total        | \$ 242,253 | \$ 214,105 | \$ 521,351 | \$ 452,789 |

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Beginning in the first quarter of 2006, general and administrative ( G&A ) costs that have been identified as directly or closely attributable to our reportable segments are included in our Division operating profit. Division operating profit for the second quarter and first half of 2005 has been adjusted by approximately \$86 million and \$177 million, respectively, to reflect the further allocation of our G&A costs as well as refinement of certain other historical allocations across Divisions. Also, see Note G for discussion of charges included in Division operating profit. A reconciliation of the measure of Division operating profit to consolidated earnings before income taxes is as follows:

| <i>(In thousands)</i>                         | <b>Second Quarter</b> |             | <b>First Half</b> |             |
|---|-----------------------|-------------|-------------------|-------------|
|   | <b>2006</b>           | <b>2005</b> | <b>2006</b>       | <b>2005</b> |
| Total division operating profit               | \$ 242,253            | \$ 214,105  | \$ 521,351        | \$ 452,789  |
| Corporate general and administrative expenses | (70,840)              | (71,593)    | (158,106)         | (145,337)   |
| Interest income                               | 1,086                 | 5,761       | 7,345             | 11,230      |
| Interest expense                              | (11,347)              | (15,179)    | (22,413)          | (25,562)    |
| Miscellaneous income, net                     | 6,625                 | 7,691       | 14,089            | 12,391      |
| Earnings before income taxes                  | \$ 167,777            | \$ 140,785  | \$ 362,266        | \$ 305,511  |

Total assets and goodwill by division are as follows:

| <i>(In thousands)</i>                      | <b>Total Assets</b>     |                                  | <b>Goodwill</b>         |                                  |
|--|-------------------------|----------------------------------|-------------------------|----------------------------------|
|  | <b>July 1,<br/>2006</b> | <b>December<br/>31,<br/>2005</b> | <b>July 1,<br/>2006</b> | <b>December<br/>31,<br/>2005</b> |
| North American Retail Division             | \$ 1,799,683            | \$ 1,714,428                     | \$ 2,046                | \$ 1,952                         |
| North American Business Solutions Division | 1,169,941               | 970,667                          | 335,040                 | 190,532                          |
| International Division                     | 2,462,609               | 2,278,030                        | 754,341                 | 688,698                          |
| Total reportable segments                  | 5,432,233               | 4,963,125                        | 1,091,427               | 881,182                          |
| Other                                      | 775,452                 | 1,135,400                        |                         |                                  |
| Total                                      | \$ 6,207,685            | \$ 6,098,525                     | \$ 1,091,427            | \$ 881,182                       |

The change in goodwill for the first half of 2006 results from the acquisitions described in Note B, as well as the impact of changes in foreign currency exchange rates.

#### **Note G Asset Impairments, Exit Costs and Other Charges**

During 2005, we announced a number of material charges relating to asset impairments, exit costs and other operating decisions. This announcement followed a wide-ranging assessment of assets and commitments which began in the second quarter of 2005. Through the end of 2005, we recorded \$282 million of charges related to certain of these identified activities. We also indicated that additional charges would be recognized in future periods as we complete projects currently underway and implement the remaining projects. For additional discussion of these charges, see our 2005 Annual Report on Form 10-K filed with the SEC. As with any estimate, the amounts may change when projects are implemented. Additionally, changes in foreign currency exchange rates may impact amounts reported in U.S. dollars related to foreign projects.

During the second quarter and first half of 2006, we recorded approximately \$8 million and \$27 million, respectively, of charges related to these previously-identified activities (the Second Quarter Charges and the Year-To-Date Charges ). These charges related primarily to consolidation and streamlining activities and are included, as appropriate, in cost of goods sold and occupancy costs, store and warehouse operating and selling expenses, and general and administrative expenses.



Included in the Second Quarter Charges, are one-time termination benefits, accelerated depreciation, and other associated costs of approximately \$4 million, \$2 million and \$2 million, respectively. Of this amount, approximately \$1 million is included in the North American Retail Division, \$4 million is included in the North American Business Solutions Division, and \$3 million is included in the International Division.

Included in the Year-To-Date Charges, are one-time termination benefits, lease and contract obligations, accelerated depreciation and other associated costs as indicated in the table below. Of this amount, approximately \$2 million is included in the North American Retail Division, \$5 million is included in the North American Business Solutions Division, \$19 million is included in the International Division and \$1 million is included in corporate general and administrative expenses.

Exit and other costs incurred during the first half of 2006, and changes in exit cost accruals related to these previously-identified activities are as follows:

| <i>(In millions)</i>           | Beginning<br>Balance<br>at 1/1/06 | Charge<br>incurred | Cash<br>payments | Non-cash<br>settlements | Currency<br>and Other<br>Adjustments | Ending<br>Balance at<br>7/1/06 |
|--------------------------------|-----------------------------------|--------------------|------------------|-------------------------|--------------------------------------|--------------------------------|
| One-time termination benefits  | \$ 6                              | \$ 18              | \$ (12)          | \$                      | \$                                   | \$ 12                          |
| Lease and contract obligations | 23                                | 1                  | (7)              |                         | 2                                    | 19                             |
| Accelerated depreciation       |                                   | 5                  |                  | (5)                     |                                      |                                |
| Other associated costs         | 2                                 | 3                  | (1)              |                         | (1)                                  | 3                              |
| <b>Total</b>                   | <b>\$ 31</b>                      | <b>\$ 27</b>       | <b>\$ (20)</b>   | <b>\$ (5)</b>           | <b>\$ 1</b>                          | <b>\$ 34</b>                   |

#### **Note H Pension Disclosures**

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

| <i>(In millions)</i>             | <b>Second Quarter</b> |               | <b>First Half</b> |               |
|----------------------------------|-----------------------|---------------|-------------------|---------------|
|                                  | <b>2006</b>           | <b>2005</b>   | <b>2006</b>       | <b>2005</b>   |
| Service cost                     | \$ 2.0                | \$ 1.9        | \$ 3.9            | \$ 3.9        |
| Interest cost                    | 2.9                   | 2.5           | 5.7               | 5.3           |
| Expected return on plan assets   | (1.9)                 | (2.1)         | (3.8)             | (4.0)         |
| <b>Net periodic pension cost</b> | <b>\$ 3.0</b>         | <b>\$ 2.3</b> | <b>\$ 5.8</b>     | <b>\$ 5.2</b> |

For the quarter and year-to-date periods ended July 1, 2006, we have contributed approximately \$1 million and \$2 million, respectively, to our foreign pension plans. No significant changes are currently anticipated in our 2006 annual contributions compared to 2005.

## **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

### **GENERAL**

Office Depot, Inc., together with our subsidiaries, is a global supplier of office products and services. We sell to consumers and businesses of all sizes through our three reportable segments (or Divisions): North American Retail Division, North American Business Solutions Division, and International Division.

Management's Discussion and Analysis of Financial Condition and Results of Operations ( MD&A ) is intended to provide information to assist you in better understanding and evaluating our financial condition and results of operations. We recommend that you read this MD&A in conjunction with our condensed consolidated financial statements and the notes to those statements included in Item 1 of this Quarterly Report on Form 10-Q, as well as our 2005 Annual Report on Form 10-K, filed with the U.S. Securities and Exchange Commission (the SEC ).

This MD&A contains significant amounts of forward-looking information. Without limitation, when we use the words believe, estimate, plan, expect, intend, anticipate, continue, may, project, probably, should and this Quarterly Report on Form 10-Q, we are identifying forward-looking statements. Our discussion of Risk Factors, found in Item 1A of this Form 10-Q and our 2005 Annual Report on Form 10-K, and Forward-Looking Statements, found immediately following the MD&A in our 2005 Annual Report on Form 10-K, apply to these forward-looking statements.

### **RESULTS OF OPERATIONS**

#### **OVERVIEW**

A summary of factors important to understanding the second quarter results are provided below and further discussed in the narrative that follows this overview.

Second quarter sales grew 4% to \$3.5 billion when compared to the second quarter of 2005. Sales in North America were up 5%, while International sales increased 1% in U.S. dollars and 2% in local currencies. North American Retail Division comparable store sales were up 1% for the quarter.

Total Company sales for the first half of 2006 grew 3% to \$7.3 billion compared to the first half of 2005. North American Retail comparable store sales increased 2% for the first half of 2006.

During the second quarter, we completed the previously announced acquisitions of businesses in South Korea and North America, and acquired an incremental interest leading to a majority stake in our business in Israel. While each of these businesses provides growth opportunities in the future, they did not have a significant impact on second quarter performance.

As part of our previously announced streamlining activities, we recorded \$8 million of charges in the second quarter of 2006 (the Second Quarter Charges ) and an aggregate of \$27 million of charges for the first half of 2006 (the Year-To-Date Charges ). These projects are expected to continue throughout 2006 and future years. The charges will be recorded when the related accounting recognition criteria are met.

Gross profit as a percentage of sales was 30.9%, a 10 basis point improvement from the same period last year. Gross margin in the North American Retail Division increased while our North American Business Solutions Division and our International Division posted slight decreases, primarily due to cost pressures in certain product groups.

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Our overall performance benefited from continuing our strategy of tailored marketing efforts and from expense leverage on the increased sales. We are also seeing the benefits of operational efficiencies taking hold.

Total operating expenses for the second quarter were 25.9% of sales, an improvement of approximately 70 basis points compared to the same quarter of the prior year.

Our effective tax rate declined in the second quarter of 2006 compared to the first quarter of 2006. We now expect our full year effective rate to be in the range of 30 to 31 percent.

Cash flows from operations increased on a year-to-date basis in 2006, primarily reflecting our working capital initiatives, including the timing of cash payments.

During the second quarter and first half of 2006, we acquired approximately 7 million shares and 19 million shares, respectively, of our common stock under publicly announced programs.

Overall

| <i>(Dollars in millions)</i>                       | Second Quarter |        |            |        | First Half |        |            |        |
|--|----------------|--------|------------|--------|------------|--------|------------|--------|
|  | 2006           |        | 2005       |        | 2006       |        | 2005       |        |
| Sales  | \$ 3,494.9     | 100.0% | \$ 3,364.1 | 100.0% | \$ 7,310.6 | 100.0% | \$ 7,066.9 | 100.0% |
| Cost of goods sold and occupancy costs             | 2,416.7        | 69.1%  | 2,327.9    | 69.2%  | 5,030.5    | 68.8%  | 4,879.0    | 69.0%  |
| Gross profit                                       | 1,078.2        | 30.9%  | 1,036.2    | 30.8%  | 2,280.1    | 31.2%  | 2,187.9    | 31.0%  |
| Store and warehouse operating and selling expenses | 756.5          | 21.7%  | 740.3      | 22.0%  | 1,600.0    | 21.9%  | 1,568.1    | 22.2%  |
| Allocated G&A                                      | 79.5           | 2.3%   | 81.8       | 2.5%   | 158.8      | 2.2%   | 167.0      | 2.4%   |
| Division operating profit                          | 242.2          | 6.9%   | 214.1      | 6.3%   | 521.3      | 7.1%   | 452.8      | 6.4%   |
| General and administrative expenses                | 70.8           | 2.0%   | 71.6       | 2.1%   | 158.1      | 2.1%   | 145.3      | 2.0%   |
| Operating profit                                   | \$ 171.4       | 4.9%   | \$ 142.5   | 4.2%   | \$ 363.2   | 5.0%   | \$ 307.5   | 4.4%   |

Beginning with the first quarter of 2006, we now include in our Division operating profit those general and administrative ( G&A ) costs that have been identified as directly or closely attributable to those units. After allocating these costs to the Divisions, a certain amount of corporate G&A remains unallocated. We have also refined certain other historical allocations across Divisions. Prior period results have been recast for meaningful comparison. Other companies may charge more or less G&A expenses to their divisions, and our results therefore may not be comparable to similarly titled measures used by some other entities. Our measure of Division operating profit should not be considered as an alternative to operating income or net earnings determined in accordance with accounting principles generally accepted in the United States of America.



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During 2005, we announced a number of material charges relating to asset impairments, exit costs and other operating decisions. This announcement followed a wide-ranging assessment of assets and commitments which began in the second quarter of 2005. Through the end of 2005, we recorded \$282 million of charges related to certain of these identified activities. We also indicated that additional charges would be recognized in future periods as remaining projects are implemented and accounting recognition criteria are met. For additional discussion of these charges (the 2005 Charges ), please see our 2005 Annual Report on Form 10-K filed with the SEC. As with any estimate, the amounts may change when projects are implemented. Additionally, changes in foreign currency exchange rates may impact amounts reported in U.S. dollars related to foreign operations.

The Second Quarter Charges and Year-To-Date Charges of 2006 are included in the following lines in our Condensed Consolidated Statement of Earnings.

| <i>(Dollars In millions)</i>                       | Second<br>Quarter<br>Charges | Year-To-Date<br>Charges |
|--|------------------------------|-------------------------|
| Cost of goods sold and occupancy costs             | \$                           | \$ 1                    |
| Store and warehouse operating and selling expenses | 6                            | 21                      |
| General and administrative expenses                | 2                            | 5                       |
| Total  | \$ 8                         | \$ 27                   |

The Year-To-Date Charges primarily relate to centralizing and consolidating activities and include one-time severance costs, lease and contract costs, accelerated depreciation and related accruals. The impact by Division is addressed in the narrative below.

North American Retail Division

| <i>(Dollars in millions)</i> | Second Quarter |            | First Half |            |
|------------------------------|----------------|------------|------------|------------|
|                              | 2006           | 2005       | 2006       | 2005       |
| Sales                        | \$ 1,507.6     | \$ 1,451.1 | \$ 3,298.3 | \$ 3,149.4 |
| % change                     | 4%             | 8%         | 5%         | 7%         |
| Division operating profit    | \$ 95.9        | \$ 76.2    | \$ 229.7   | \$ 183.1   |
| % of sales                   | 6.4%           | 5.3%       | 7.0%       | 5.8%       |

Division operating profit included approximately \$1 million of Second Quarter Charges and \$2 million of Year-To-Date Charges, primarily related to accelerated depreciation.

Second quarter sales and first half sales in the North American Retail Division increased 4% and 5% compared to the same periods last year. Comparable store sales in the 986 stores in the U.S. and Canada that have been open for more than one year increased 1% and 2% in the second quarter and first half, respectively. Comparable average ticket size continued to increase and average sales per square foot were \$229 for the second quarter.

Division operating profit margins expanded due to both a continuation of gross margin expansion and a reduction in the Division's cost structure. Gross margins improved over last year, in part reflecting an expansion in product margins driven by category management and an increase in private brand sales from both growth in existing products and the introduction of new products across many categories. Our cost management initiatives have resulted in reduced operating costs. These improvements in gross margin and savings from cost management initiatives continue to more than offset incremental expense associated with new store openings and store remodel activities now underway. Inventory per store was \$995 thousand as of the end of the second quarter of 2006, down from \$1.06 million per store in the comparable period last year.

During the second quarter, the Company opened 22 stores and relocated 2 stores. At the end of the second quarter, Office Depot operated a total of 1,071 office products stores throughout the U.S. and Canada. Our plan remains to open approximately 100 stores this year. Previously, we announced that we may accelerate our plans and remodel a large number of our stores to our M2 format in 2006. In the second quarter, we remodeled 49 stores and our plan is to complete approximately 150 stores this year with a goal of remodeling almost all stores in the next three to five years. These remodeling activities affect the performance of the North American Retail Division from both acceleration of depreciation of store assets, as well as from the costs associated with the specific remodel efforts, some of which are not capitalizable.

North American Business Solutions Division

| <i>(Dollars in millions)</i> | Second Quarter |            | First Half |            |
|------------------------------|----------------|------------|------------|------------|
|                              | 2006           | 2005       | 2006       | 2005       |
| Sales                        | \$ 1,128.7     | \$ 1,065.9 | \$ 2,258.7 | \$ 2,116.9 |
| % change                     | 6%             | 7%         | 7%         | 5%         |
| Division operating profit    | \$ 100.8       | \$ 86.8    | \$ 193.3   | \$ 161.0   |
| % of sales                   | 8.9%           | 8.1%       | 8.6%       | 7.6%       |

Division operating profit for the second quarter and first half of 2006 included approximately \$4 million and \$5 million of Second Quarter Charges and Year-To-Date Charges, respectively, related to efficiency activities initiated during last year as part of the 2005 Charges. It is anticipated that the North American Business Solutions Division will recognize an additional \$16 million during the remainder of 2006, though costs related to these projects may differ as the actual plans are implemented. In addition to these projects, the North American Business Solutions Division expects to recognize additional costs in 2007 and 2008 for future network optimization projects.

North American Business Solutions Division sales increased by 6% for the second quarter and 7% for the first half of 2006 compared to the same periods in the prior year. This Division experienced growth in key product categories, and Division average order values and transactions increased compared to the second quarter of 2005. We also completed the acquisition of Allied Office Products, a contract stationer, whose results have been consolidated into our results for the portion of the quarter since acquisition.

Division operating profit margins expanded due to lower costs which were slightly offset by a modest decline in gross margin. Overall gross margin for the Division was negatively impacted by cost pressures in certain product categories and a shift in the mix of sales. Expense leverage was achieved from call center optimization efforts initiated in past quarters and from current period advertising efficiencies. We invested in the expansion of our sales force in the quarter and we estimate the expansion pays out within one year. Our supply chain continued its history of improvements in operating expense leverage.

International Division

| <i>(Dollars in millions)</i> | Second Quarter |          | First Half |            |
|------------------------------|----------------|----------|------------|------------|
|                              | 2006           | 2005     | 2006       | 2005       |
| Sales                        | \$ 858.6       | \$ 847.8 | \$ 1,753.6 | \$ 1,802.1 |
| % change                     | 1%             | 3%       | (3%)       | %          |
| Division operating profit    | \$ 45.5        | \$ 51.1  | \$ 98.5    | \$ 108.8   |
| % of sales                   | 5.3%           | 6.0%     | 5.6%       | 6.0%       |

Division operating profit includes approximately \$3 million of Second Quarter Charges and \$19 million of Year-To-Date Charges related to efficiency activities identified last year as part of the business review disclosed in our Form 10-K for 2005. It is anticipated that the International Division will record an additional \$14 million of charges during the remainder of 2006 as these plans are implemented and the accounting recognition criteria are met. However, costs related to these projects may differ as the actual plans are implemented and foreign currency exchange rates may impact the amount reported in U.S. dollars. In addition to costs associated with these projects, the International Division expects to recognize costs in 2007 and 2008 for future network optimization projects.

International Division second quarter sales increased 1% in U.S. dollars and 2% in local currencies compared to the same period in 2005. Sales for the first half of 2006 decreased 3% in U.S. dollars, but increased 2% in local currencies. The change in exchange rates from the corresponding prior year period decreased sales reported in U.S. dollars by approximately \$8 million for the quarter and \$88 million for the year-to-date period. During the second quarter, we completed the previously announced acquisition of Best Office, an office supply company located in South Korea and increased our ownership interest to a majority stake in Office Depot Israel. Their results have been consolidated into our results for the part of the second quarter since acquisition.

The operating profit margin for 2006 was impacted by a slight decline in gross margin which was due to the effect of the mix of sales, and continued pricing and cost pressures in key product categories. This decline was offset by broad based expense savings resulting from consolidation and cost management efforts. Also, Division operating profit now includes general and administrative expenses that are considered direct and closely attributable to the Division that previously were reported at a corporate level. The comparison for the second quarter is impacted by the allocation of certain one-time credits realized in 2005 that increased the prior year operating margin by as much as 70 basis points. The International Division increased the size of its contract sales force in the quarter and increased the use of telephone account managers for customer acquisition activity. These activities are expected to continue throughout the rest of the year.

We have continued the consolidation of our supply chain operations in Europe with the recent closures of four locations. We have also integrated our supply chain operations in France, enabling next day delivery throughout the country.

The macro economic environment in Europe remains somewhat challenging but we are beginning to gain traction in our efforts to optimize our cost structure as well as grow our top line sales. We are also making progress in the integration of our newly acquired businesses in Israel and South Korea. We remain optimistic on the long term potential of our International business.

*Corporate and Other*

*General and Administrative ( G&A ) Expenses:* As a percentage of sales, total G&A expenses decreased to 4.3% in the second quarter of 2006 and 4.3% in the first half of 2006, compared to 4.6% and 4.4% for the same periods last year. As noted above, the portion of G&A considered directly or closely related to unit activity is now included in the measurement of Division operating profit and prior periods have been recast for comparison. The remaining corporate G&A as a percentage of sales decreased during the second quarter and was relatively flat for first half of 2006 compared to the same periods of 2005. The second quarter of 2006 reflects the impact of cost control activities, partially offset by the expense recognition of stock options and other employee-related costs.

*Other income (expense):* Other income and expense, net for the second quarter of 2006 reflects a decline in interest income on lower average cash balances as we have continued to acquire Company shares and fund acquisitions.

*Income Taxes:* Our effective tax rate for the second quarter and first half of 2006 was 29.5% and 31.6%, respectively. The effective tax rate may change due to shifts in domestic and international income and other factors. We anticipate our full year base operating rate to be in a range of 30% to 31%, though unforeseen events may impact the actual rate experienced.

## **LIQUIDITY AND CAPITAL RESOURCES**

At July 1, 2006, we had approximately \$341.4 million of cash and cash equivalents, as well as \$599.5 million of available credit under our revolving credit facility. The credit availability reflects coverage of \$83.6 million of outstanding letters of credit. We had an additional \$74.6 million of letters of credit outstanding under separate trade agreements. We anticipate having sufficient liquidity to fund operations, planned store expansion, store remodels and other capital expenditures. We continue to evaluate and expect to execute further repurchases of our common stock based on cash flow and other considerations.

During the first half of 2006, cash provided by operating activities was \$483.8 million compared to \$86.4 million during the same period last year. This change is primarily attributable to working capital improvements, including the timing of cash payments.

Cash used in investing activities was \$276.3 million in the first half of 2006 compared to \$175.0 million in the same period last year. This increase was primarily the result of the acquisitions we completed during the second quarter of 2006. The use of cash for the first half of 2006 also reflects capital expenditures from the opening and relocation of a total of 30 new office supply stores in North America, as well as our store remodel program and investments in information technology. Investing activities in 2005 included capital expenditures from the opening of 46 new stores and five relocations in North America. We anticipate capital spending totaling \$350 to \$400 million in 2006.

Cash used in financing activities was \$578.3 million in the first half of 2006 compared to \$43.8 million during the same period in 2005. Open market purchases of our common stock totaled \$670.2 million and payments on long-term borrowings totaled \$22.7 million. These uses of cash were partially offset by proceeds from issuance of common stock under our employee related plans of \$82.1 million, as well as \$32.5 million in tax benefits from employee exercises of share-based awards.

## **CRITICAL ACCOUNTING POLICIES**

Our condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. Preparation of these statements requires management to make judgments and estimates. Some accounting policies have a significant impact on amounts reported in these financial statements. A summary of significant accounting policies and a description of accounting policies that are considered critical may be found in our 2005 Annual Report on Form 10-K, filed on February 15, 2006, in the Notes to the Consolidated Financial Statements, Note A, and the Critical Accounting Policies section.

### **New Accounting Pronouncement**

In July 2006, the Financial Accounting Standards Board issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*. This Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The Interpretation is effective for fiscal years beginning after December 15, 2006. We have not yet analyzed the impact this Interpretation will have on our financial condition, results of operations, cash flows or disclosures.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

**Interest Rate Risks**

At July 1, 2006, there had not been a material change in the interest rate risk information disclosed in the Market Sensitive Risks and Positions subsection of the Management's Discussion and Analysis of Financial Condition and Results of Operations set forth in Item 7 of our 2005 Annual Report on Form 10-K.

**Foreign Exchange Rate Risks**

At July 1, 2006, there had not been a material change in any of the foreign exchange risk information disclosed in the Market Sensitive Risks and Positions subsection of the Management's Discussion and Analysis of Financial Condition and Results of Operations set forth in Item 7 of our 2005 Annual Report on Form 10-K.

**Item 4. Controls and Procedures**

- (a) Disclosure Controls and Procedures. The company's management, with the participation of the company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)) as of the end of the period covered by this report. Based on that evaluation, these officers have concluded that the corporation's disclosure controls and procedures are effective for the purpose of ensuring that material information required to be in this quarterly report is made known to them by others on a timely basis and that information required to be disclosed by the company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.
- (b) Changes in Internal Controls. The company is continuously seeking to improve the efficiency and effectiveness of its operations and of its internal controls. This results in refinements to processes throughout the company. However, there has been no change in the company's internal control over financial reporting that occurred during the company's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting.

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

We are involved in litigation arising in the normal course of our business. While, from time to time, claims are asserted that make demands for large sums of money (including, from time to time, actions which are asserted to be maintainable as class action suits), we do not believe that any of these matters, either individually or in the aggregate, will materially affect our financial position or the results of our operations.

### **Item 1A. Risk Factors**

In addition to risks and uncertainties in the ordinary course of business that are common to all businesses, important factors that are specific to our industry and our company could materially impact our future performance and results. We have provided below a list of these risk factors that should be reviewed when considering our securities. These are not all the risks we face, of course, and other factors currently considered immaterial or unknown to us may impact our future operations.

**Competition:** We compete with a variety of retailers, dealers, distributors, contract stationers, direct marketers and internet operators throughout our worldwide operations. This is a highly competitive marketplace that includes such retail competitors as office supply stores, warehouse clubs, computer and electronics stores, mass merchant retailers, local merchants, grocery and drug-store chains as well as other competitors including direct mail and internet merchants, contract stationers, and direct manufacturers. Our competitors may be local, regional, national or international. Further, competition may come from highly-specialized low-cost merchants, including ink refill stores and kiosks, original equipment manufacturers, concentrated direct marketing channels or well-funded and broad-based enterprises. There is a possibility that any or all of these competitors could become more aggressive in the future, thereby increasing the number and breadth of our competitors.

In recent years, new and well-funded competitors have begun competing in certain aspects of our business. For example, two major common carriers of goods completed acquisitions of retail outlets that will allow them to compete directly for copy, printing, packaging and shipping business, and possibly offer products and services similar to ones we offer.

In order to achieve and maintain expected profitability levels in our three operating divisions, we must continue to grow by adding new customers and taking market share from competitors, while maintaining service levels, and aggressive pricing necessary to retain existing customers. If we fail to adequately address and respond to these pressures in both North America and internationally, it could have a material adverse effect on our business and results of our operations.

**Execution of Expansion Plans:** We plan to continue our store expansion in the North American Retail Division, as well as in our International Division during 2006. Circumstances outside our control could negatively impact these anticipated store openings. We cannot determine with certainty whether our new store openings, including some newly sized or formatted stores or retail concepts, will be successful. The failure to expand by successfully opening new stores as planned, or the failure of a significant number of these stores to perform as planned, could have a material adverse effect on our business and results of our operations.

**Cannibalization of Sales in Existing Office Depot Stores:** As we expand the number of our stores in existing markets, pursuing a fill-in strategy that is both offensive and defensive in nature, sales in our existing stores may suffer from cannibalization (as customers of our existing stores begin shopping at our own new stores). Extensive cannibalization of existing stores, as we open new stores, could have a material adverse effect on our business and results of our operations.

**Costs of Remodeling and Re-merchandising Stores:** Remodeling and re-merchandising our stores is a necessary aspect of maintaining a fresh and appealing image to our customers. The expenses associated with such activities could have a significant negative impact on our future earnings. Our growth, through both store openings and possible acquisitions, may continue to require the expansion and upgrading of our information, operational and financial systems, as well as necessitate the hiring of new store associates at all levels. If we are unsuccessful in achieving an acceptable ROI on this design, unsuccessful at hiring the right associates, or unsuccessful at implementing appropriate systems, such failure could have a material adverse effect on our business and results of our operations.

**International Activity:** We may enter additional international markets as attractive opportunities arise. Such entries could take the form of start-up ventures, acquisitions of stock or assets or joint ventures or licensing arrangements. Internationally, we face such risks as foreign currency fluctuations, unstable political and economic conditions, and, because some of our foreign operations are not wholly owned, compromised operating control in certain countries. Our results may continue to be affected by all of these factors. All of these risks could have a material adverse effect on our business and results of our operations.

**Global Sourcing of Products/Private Brand:** In recent years, we have substantially increased the number and types of products which we sell under our own Office Depot®, Viking®, Foray , Niceday , Ativa<sup>TM</sup> and other private brands. Sources of supply may prove to be unreliable, or the quality of the globally sourced products may vary from our expectations. Economic and civil unrest in areas of the world where we source some of these products, as well as shipping and dockage issues could adversely impact the availability or cost of such products, or both. Moreover, as we seek indemnities from the manufacturers of these products, the uncertainty of realization of any such indemnity and the lack of understanding of U.S. product liability laws in certain parts of the world make it more likely that we may have to respond to claims or complaints from our customers as if we were the manufacturer of the products. Any of these circumstances could have a material adverse effect on our business and results of our operations.

**Product Availability:** In addition to selling our private brand merchandise, we are a reseller of other manufacturer s branded items and are thereby dependant on the availability and pricing of key products including ink, toner, paper and technology products, to name a few. As a reseller, we cannot control the supply, design, function or cost of many of the products we offer for sale. Disruptions in the availability of raw materials used in production of these products may adversely affect our sales and result in customer dissatisfaction. Further, we cannot control the cost of manufacturer s products and cost increases must either be passed along to our customers or will result in erosion of our earnings. Failure to identify desirable products and make them available to our customers when desired and at attractive prices could have a material adverse effect on our business and results of operations.

**Possible Business Disruption Due to Weather:** Weather conditions may affect any business, especially retail businesses, including snow storms in the northern states, high winds and heavy rain. Because of our heavy concentration in the southern United States (including Florida and the Gulf Coast) our Company may be more susceptible than some others to the effects of tropical weather disturbances. During 2005, for example, we sustained disruption to our businesses in the United States due to the number and severity of tropical weather events in the southeastern United States, including a record numbers of hurricanes. While we have been able to recover quickly from these events during the past two years, the long-range weather forecast calls for higher than normal tropical storm activity, especially in the southeastern United States. It is impossible to know whether these storms will occur as forecast, or if they do, the location or severity of such storms. We believe that we have taken reasonable precautions to prepare for such weather-related events and are better prepared than many companies for such events, but there is no assurance that our precautions will be adequate to deal with such events in the future. If these events occur as forecast, and if they should impact areas in which we have concentrations of retail stores or distribution facilities, such events could have a materially adverse effect on our financial position or operating results in the future.



**New Systems and Technology:** We frequently modify our systems and technology to increase productivity and efficiency. We are undertaking a number of system enhancements and conversions that, if not done properly, could divert the attention of our workforce during development and implementation and constrain for some time our ability to provide the level of service our customers demand. Also, when implemented, the systems and technology may not provide the benefits anticipated and could add costs and complications to our ongoing operations. A failure to effectively convert to these systems or to realize the intended efficiencies could have a material adverse effect on our business and results of our operations.

**Labor Costs:** We are heavily dependent on our labor force to identify new customers and provide desired products and services to existing customers. We attempt to attract and retain an appropriate level of personnel in both field operations and corporate functions. Our compensation packages are designed to provide benefits commensurate with our level of expected service. However, as a retailer, we face the challenge of filling many positions at wage scales that are low, although appropriate to the industry and competitive factors. As a result, we face many external risks and internal factors in meeting our labor needs, including competition for qualified personnel, overall unemployment levels, international labor works councils (in our international locations), prevailing wage rates, as well as rising employee benefit costs, including insurance costs and compensation programs. We also engage third parties in some of our processes such as delivery and transaction processing and these providers may face similar issues. Changes in any of these factors, including especially a shortage of available workforce in the areas in which we operate, could interfere with our ability to adequately provide services to customers and result in increasing our labor costs. Any failure to meet increasing demands on securing our workforce could have a material adverse effect on our business and results of our operations.

**Operating Costs:** We operate a large network of stores and distribution centers around the globe. As such, we purchase significant amounts of fuel needed to transport products to our stores and customers. We also incur significant shipping costs to bring products from overseas producers to our distribution systems. The underlying commodity costs associated with this transport activity have been volatile in recent periods and disruptions in availability of fuel could cause our operating costs to rise significantly. Additionally, we rely on predictable and available energy costs to light, cool and heat our retail stores, distribution centers and call centers and to operate our equipment. Increases in any of the components of energy costs could have an adverse impact on our earnings, as well as our ability to satisfy our customers in a cost effective manner. Any of these factors that could impact the availability or cost of our energy resources could have a material adverse effect on our business and results of our operations.

**Possible Changes to our Global Tax Rate:** Our company is a multi-national, multi-channel reseller of office products and services. As a result of our operations in many foreign countries, in addition to the United States, our global tax rate is derived from a combination of applicable tax rates in the various jurisdictions in which we operate. Depending upon the sources of our income, any agreements we may have with taxing authorities in various jurisdictions, and the tax filing positions we take in various jurisdictions, our overall tax rate may be lower or higher than that of other companies or higher or lower than our tax rates have been in the past. We base our estimate of an annual effective tax rate at any given point in time upon a calculated mix of the tax rates applicable to our company and to estimates of the amount of business likely to be done in any given geography. The loss of one or more agreements with taxing jurisdictions, a change in the mix of our business from year to year and from country to country, changes in rules related to accounting for income taxes, or changes in tax laws in any of the multiple jurisdictions in which we operate or adverse outcomes from the tax audits that regularly are in process in any of the jurisdictions in which we operate could result in an unfavorable change in our overall tax rate, which change could have a material adverse effect on our business and results of our operations.

**Disclaimer of Obligation to Update**

We assume no obligation (and specifically disclaim any such obligation) to update these Risk Factors or any other forward-looking statements contained in this Report to reflect actual results, changes in assumptions or other factors affecting such forward-looking statements.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

The following table provides information with respect to company purchases made of Office Depot, Inc. common stock during the second quarter of the 2006 fiscal year:

| Period                         | (a) Total<br>Number<br>of Shares<br>Purchased | (b)<br>Average<br>Price Paid<br>per Share | (c) Total<br>Number<br>of Shares<br>Purchased as<br>Part<br>of Publicly<br>Announced<br>Plans<br>or Programs <sup>(1)</sup> | (d) Maximum<br>Number of<br>Shares<br>(or Approximate<br>Dollar Value)<br>that<br>May Yet Be<br>Purchased<br>Under<br>the Plans or<br>Programs |
|--------------------------------|---|---|---|--|
| April 2, 2006 - April 29, 2006 | 7,049,620 <sup>(2)</sup>                      | \$ 37.55                                  | 6,745,400   | \$ 8,058,661   |
| April 30, 2006 - May 27, 2006  | 198,300                                       | \$ 40.65                                  | 198,300   | \$ 500,000,000   |
| May 28, 2006 - July 1, 2006    |   |   |   | \$ 500,000,000   |
| Total                          | 7,247,920                                     | \$ 37.63                                  | 6,943,700   | \$ 500,000,000   |

- (1) On February 15, 2006, the board of directors authorized a common stock repurchase program whereby we were authorized to repurchase up to \$500 million of our common stock. This program commenced on February 27, 2006 and concluded on May 3, 2006. On May 12, 2006, the board of directors authorized a common stock repurchase program whereby we are authorized to repurchase an additional \$500 million of our common stock.
- (2) Includes 304,220 shares of common stock delivered or restricted shares of common stock withheld to pay income tax or other tax liabilities with respect to the vesting of restricted stock, exercise of stock options, or the settlement of performance share awards.

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

The Company's annual meeting of stockholders was held on May 12, 2006. Of the total number of common shares outstanding on March 10, 2006, a total of 232,966,564 were represented in person or by proxy. Results of votes with respect to proposals submitted at that meeting are as follows:

- a. To elect 10 nominees to serve as directors to hold office until the next annual meeting of our stockholders or until their successors have been elected and qualified. Our stockholders voted to elect all 10 nominees to serve as directors. Votes recorded, by nominee, were as follows:

| <b>Nominee</b>    | <b>For</b>  | <b>Against/<br/>Withheld</b> |
|-------------------|-------------|------------------------------|
| Lee A. Ault, III  | 223,218,091 | 9,748,472                    |
| Neil R. Austrian  | 224,005,038 | 8,961,525                    |
| David W. Bernauer | 229,930,913 | 3,035,650                    |
| Abelardo E. Bru   | 224,604,320 | 8,362,243                    |
| David I. Fuente   | 126,554,363 | 106,412,200                  |
| Brenda J. Gaines  | 230,106,175 | 2,860,388                    |
| Myra M. Hart      | 224,738,037 | 8,228,526                    |
| W. Scott Hedrick  | 219,318,407 | 13,648,156                   |
| Michael J. Myers  | 224,819,806 | 8,146,757                    |
| Steve Odland      | 224,687,999 | 8,278,564                    |

- b. To ratify our Board's appointment of Deloitte & Touche LLP as our independent public accountants for the 2006 fiscal year. Our stockholders voted to approve this proposal with 224,986,873 votes for and 6,415,782 votes against. There were 1,563,907 abstentions and 59,666,769 broker non-votes.
- c. To consider a Proposal from a Shareholder recommending that our Board of Directors initiate the appropriate process to amend the governance documents (certificate of incorporation or bylaws) of the Company to provide that Director nominees shall be elected by the affirmative vote of the majority of the votes cast at an annual meeting of shareholders. Our stockholders voted to approve this proposal with 116,687,638 votes for and 88,798,461 against. There were 1,762,724 abstentions and 85,384,508 broker non-votes.

**Item 6. Exhibits**

Exhibits

- 31.1 Rule 13a-14(a)/15d-14(a) Certification of CEO  
 31.2 Rule 13a-14(a)/15d-14(a) Certification of CFO  
 32 Section 1350 Certification

**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.

OFFICE DEPOT, INC.

(Registrant)

Date: July 28, 2006

By: /s/ Steve Odland  
Steve Odland  
Chief Executive Officer and Chairman,  
Board of Directors (Principal Executive  
Officer)

Date: July 28, 2006

By: /s/ Patricia McKay  
Patricia McKay  
Executive Vice President and Chief  
Financial Officer (Principal Financial  
Officer)

Date: July 28, 2006

By: /s/ Randy T. Pianin  
Randy T. Pianin  
Senior Vice President, Finance and  
Controller (Principal Accounting  
Officer)