OFFICE DEPOT INC
Form 10-Q
October 17, 2006

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

(Mark One)

þ **Quarterly Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934**
For the quarterly period ended September 30, 2006
or

o **Transition Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934**
For the transition period from ________________ to ___________________
Commission file number 1-10948

**Office Depot, Inc.**
(Exact name of registrant as specified in its charter)

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

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes x No o

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

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

The number of shares outstanding of the registrant s common stock, as of the latest practicable date: At September 30, 2006 there were 278,408,638 outstanding shares of Office Depot, Inc. Common Stock, $0.01 par value.

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

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

| | As of September 30, 2006 | As of December 31, 2005 |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 328,924 | $ 703,197 |
| Short-term investments | | 200 |
| Receivables, net | 1,442,229 | 1,232,107 |
| Inventories, net | 1,414,342 | 1,360,274 |
| Deferred income taxes | 128,037 | 136,998 |
| Prepaid expenses and other current assets | 115,456 | 97,286 |
| Total current assets | 3,428,988 | 3,530,062 |
| Property and equipment, net | 1,396,179 | 1,311,737 |
| Goodwill | 1,119,700 | 881,182 |
| Other assets | 456,406 | 375,544 |
| Total assets | $ 6,401,273 | $ 6,098,525 |
| **Liabilities and stockholders equity** | | |
| Current liabilities: | | |
| Trade accounts payable | $ 1,535,162 | $ 1,324,198 |
| Accrued expenses and other current liabilities | 1,194,420 | 979,796 |
| Income taxes payable | 146,952 | 117,487 |
| Short-term borrowings and current maturities of long-term debt | 34,875 | 47,270 |
| Total current liabilities | 2,911,409 | 2,468,751 |
| Deferred income taxes and other long-term liabilities | 387,412 | 321,455 |
| Long-term debt, net of current maturities | 591,455 | 569,098 |
| Minority interest | 10,453 | |
| Commitments and contingencies | | |
| Stockholders equity: | | |
| Common stock authorized 800,000,000 shares of $.01 par value; issued and outstanding shares - 425,660,487 in 2006 and 419,812,671 in 2005 | 4,257 | 4,198 |

| | | |
|---|---|---|
| Additional paid-in capital | 1,677,700 | 1,517,373 |
| Accumulated other comprehensive income | 244,506 | 140,745 |
| Retained earnings | 3,248,162 | 2,867,067 |
| Treasury stock, at cost 147,251,849 shares in 2006 and 122,787,210 shares in 2005 | (2,674,081) | (1,790,162) |
| Total stockholders equity | 2,500,544 | 2,739,221 |
| Total liabilities and stockholders equity | $ 6,401,273 | $ 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 | | 39 Weeks Ended | |
|---|---|---|---|---|
| | September 30, 2006 | September 24, 2005 | September 30, 2006 | September 24, 2005 |
| Sales | $ 3,857,144 | $ 3,492,900 | $11,167,751 | $10,559,843 |
| Cost of goods sold and occupancy costs | 2,670,305 | 2,446,301 | 7,700,764 | 7,325,342 |
| Gross profit | 1,186,839 | 1,046,599 | 3,466,987 | 3,234,501 |
| Store and warehouse operating and selling expenses | 834,121 | 841,246 | 2,434,147 | 2,409,398 |
| Asset impairment | | 121,902 | | 121,902 |
| General and administrative expenses | 161,237 | 180,168 | 478,114 | 492,466 |
| Operating profit (loss) | 191,481 | (96,717) | 554,726 | 210,735 |
| Other income (expense): | | | | |
| Interest income | 2,101 | 6,302 | 9,446 | 17,532 |
| Interest expense | (10,724) | (6,576) | (33,137) | (32,138) |
| Miscellaneous income, net | 6,357 | 5,540 | 20,446 | 17,931 |
| Earnings (loss) before income taxes | 189,215 | (91,451) | 551,481 | 214,060 |
| Income taxes | 55,956 | (43,570) | 170,386 | 46,534 |
| Net earnings (loss) | $ 133,259 | $ (47,881) | $ 381,095 | $ 167,526 |
| Earnings (loss) per common share: | | | | |
| Basic | $ 0.48 | $ (0.15) | $ 1.34 | $ 0.54 |
| Diluted | 0.47 | (0.15) | 1.31 | 0.53 |
| Weighted average number of common shares outstanding: | | | | |
| Basic | 279,298 | 311,915 | 283,859 | 312,690 |
| Diluted | 284,872 | 311,915 | 290,179 | 317,640 |

*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)**

| | 39 Weeks Ended | |
|---|---|---|
| | **September 30, 2006** | **September 24, 2005** |
| **Cash flow from operating activities:** | | |
| Net earnings | $ 381,095 | $ 167,526 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | |
| Depreciation and amortization | 204,655 | 205,274 |
| Charges for losses on inventories and receivables | 72,151 | 65,321 |
| Asset impairments | | 121,902 |
| Changes in working capital and other | 134,542 | (145,673) |
| Net cash provided by operating activities | 792,443 | 414,350 |
| **Cash flows from investing activities:** | | |
| Capital expenditures | (217,596) | (201,217) |
| Acquisitions, net of cash acquired | (199,917) | |
| Proceeds from disposition of assets | 22,839 | 46,419 |
| Purchase of short-term investments | (961,450) | (1,534,215) |
| Sale of short-term investments | 961,650 | 1,445,687 |
| Other | 1,207 | |
| Net cash used in investing activities | (393,267) | (243,326) |
| **Cash flows from financing activities:** | | |
| Proceeds from exercise of stock options and sale of stock under employee stock purchase plans | 90,376 | 164,863 |
| Tax benefits from employee share-based payments | 35,846 | 15,840 |
| Acquisition of treasury stock | (870,576) | (484,868) |
| Net payments on long- and short-term borrowings | (33,017) | (37,060) |
| Net cash used in financing activities | (777,371) | (341,225) |
| **Effect of exchange rate changes on cash and cash equivalents** | 3,922 | (38,825) |
| Net decrease in cash and cash equivalents | (374,273) | (209,026) |
| Cash and cash equivalents at beginning of period | 703,197 | 793,727 |
| Cash and cash equivalents at end of period | $ 328,924 | $ 584,701 |

*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 September 30, 2006 and for the 13-week and 39-week periods ending September 30, 2006 (also referred to as the third quarter of 2006 and the year-to-date 2006 ) and September 24, 2005 (also referred to as the third quarter of 2005 and the year-to-date 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 Pronouncements**

In July 2006, the Financial Accounting Standards Board ( FASB ) 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 completed our analysis of the impact this Interpretation will have on our financial condition, results of operations, cash flows or disclosures.

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

The FASB also issued in September 2006 Statement of Financial Accounting Standards No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statement No. 87, 88, 106 and 132(R),* ( FAS 158 ). This Standard requires recognition of the funded status of a benefit plan in the statement of financial position. The Standard also requires recognition in other comprehensive income certain gains and losses that arise during the period but are deferred under pension accounting rules, as well as modifies the timing of reporting and adds certain disclosures. FAS 158 provides recognition and disclosure elements to be effective as of the end of the fiscal year after December 15, 2006 and measurement elements to be effective for fiscal years ending after December 15, 2008. We have not yet analyzed the impact FAS 158 will have on our financial condition, results of operations, cash flows or disclosures.

**Note B Acquisitions**

On August 31, 2006, we completed the acquisition of Papirius s.r.o, one of the largest business-to-business suppliers of office products and services in Eastern Europe. Papirius has annual revenues of more than $56 million and has operations in the Czech Republic, Lithuania, Hungary, and Slovakia. Financial results have been included in the International Division results since acquisition.

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 $200 million. The consideration has been allocated to acquired working capital and other accounts with approximately $189 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 and certain other identifiable intangible assets may change as the integration and valuation processes are completed. Two of the acquisitions include provisions that may result in payments to the former owners based on certain measures of future profitability that may impact goodwill in future periods. 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. The size of these acquisitions is not material and therefore pro forma financial information has not been provided.

On September 28, 2006 we announced that we reached a definitive agreement to acquire a majority stake in AsiaEC, one of the largest suppliers of office products and services in China with annual sales of approximately $40 million. This transaction will be consolidated in our results in the fourth quarter following the October 12, 2006 closing.

**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 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.

| *(In thousands, except per share amounts)* | **Year-to-Date 2005** |
|---|---|
| Net earnings as reported | $167,526 |
| Stock-based employee compensation cost included in net earnings as reported, net of tax | 5,240 |
| Compensation expense under FAS 123, net of tax | (8,475) |
| Pro forma net earnings | $164,291 |
| Net earnings per share Basic | |
| As reported | $ 0.54 |
| Pro forma | 0.53 |
| Net earnings per share Diluted | |
| As reported | $ 0.53 |
| Pro forma | 0.52 |

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:

| *(In thousands)* | Third Quarter | | Year-to-Date | |
|---|---|---|---|---|
| | **2006** | **2005** | **2006** | **2005** |
| Net earnings (loss) | $133,259 | $(47,881) | $381,095 | $ 167,526 |
| Other comprehensive income (loss): | | | | |
| Foreign currency translation adjustments, net | (3,849) | (6,531) | 104,957 | (174,260) |
| Amortization of gain on cash flow hedge | (415) | (415) | (1,244) | (1,244) |
| Unrealized gain on cash flow hedge | (983) | | 48 | |
| Total comprehensive income (loss) | $128,012 | $(54,827) | $484,856 | $ (7,978) |

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

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

| *(In thousands, except per share amounts)* | Third Quarter | | Year-to-Date | |
|---|---|---|---|---|
| | **2006** | **2005** | **2006** | **2005** |
| Numerator: | | | | |
| Net earnings (loss) | $133,259 | $ (47,881) | $381,095 | $167,526 |
| Denominator: | | | | |
| Weighted average shares outstanding: | | | | |
| Basic | 279,298 | 311,915 | 283,859 | 312,690 |
| Effect of dilutive stock options and restricted stock | 5,574 | | 6,320 | 4,950 |
| Diluted | 284,872 | 311,915 | 290,179 | 317,640 |
| EPS: | | | | |
| Basic | $ 0.48 | $ (0.15) | $ 1.34 | $ 0.54 |
| Diluted | 0.47 | (0.15) | 1.31 | 0.53 |

A portion of our 2005 long-term incentive awards to employees includes approximately 870,000 shares of performance-based restricted stock that are not included in the weighted average share calculation until the underlying performance measures are met. The effects of 6.5 million common stock equivalents were not included in diluted loss per share for the third quarter of 2005 because their effect would have been anti-dilutive.

**Note F Division Information**

We continually assess our financial reporting practices and strive to provide meaningful and transparent communication of our results. Earlier this year, we initiated a process of allocating to our Divisions general and administrative expenses that we identified as directly or closely attributable to those operations and we recast our prior period results to provide for an appropriate comparison. As described more fully in Note G below, in the third quarter of 2005, we recognized material charges related to asset impairments, exit costs and other charges ( Third Quarter Charges or Charges ). During that quarter, we also indicated that additional charges of a similar nature related to certain actions taken or initiated during that quarter would be recognized as the related accounting criteria were met, in some cases over several years as projects are fully implemented. Management initially evaluated Division operating performance both excluding and including the impact of those Charges recognized during the related periods. Measurement exclusive of the Charges is now the financial information our chief operating decision maker uses to assess performance of the Divisions for the purpose of resource allocation. We believe this measure is an appropriate and useful indicator of the effectiveness of current management activities. Accordingly, for segment reporting purposes, we have modified our measurement of Division operating profit to conform to this management view of performance and have recast prior period results for meaningful comparison.

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

| *(In thousands)* | Sales | | | |
|---|---|---|---|---|
| | Third Quarter | | Year-to-Date | |
| | **2006** | **2005** | **2006** | **2005** |
| North American Retail Division | $1,767,866 | $1,635,870 | $ 5,066,206 | $ 4,785,223 |
| North American Business Solutions Division | 1,207,661 | 1,080,904 | 3,466,334 | 3,197,763 |
| International Division | 881,617 | 776,898 | 2,635,211 | 2,579,014 |
| Total reportable segments | 3,857,144 | 3,493,672 | 11,167,751 | 10,562,000 |
| Eliminations | | (772) | | (2,157) |
| Total | $3,857,144 | $3,492,900 | $11,167,751 | $10,559,843 |

| *(In thousands)* | Division Operating Profit | | | |
|---|---|---|---|---|
| | Third Quarter | | Year-to-Date | |
| | **2006** | **2005** | **2006** | **2005** |
| North American Retail Division | $120,288 | $107,907 | $351,499 | $291,000 |
| North American Business Solutions Division | 96,830 | 82,115 | 295,399 | 243,083 |
| International Division | 55,192 | 41,630 | 169,125 | 150,435 |
| Total reportable segments | 272,310 | 231,652 | 816,023 | 684,518 |
| Eliminations | (173) | (27) | (328) | (104) |
| Total | $272,137 | $231,625 | $815,695 | $684,414 |

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

| *(In thousands)* | Third Quarter | | Year-to-Date | |
|---|---|---|---|---|
| | **2006** | **2005** | **2006** | **2005** |
| Total division operating profit | $272,137 | $ 231,625 | $ 815,695 | $ 684,414 |
| Charges, as defined above | (5,447) | (236,808) | (32,333) | (236,808) |
| Corporate general and administrative expenses (excluding Charges) | (75,209) | (91,534) | (228,636) | (236,871) |
| Interest income | 2,101 | 6,302 | 9,446 | 17,532 |
| Interest expense | (10,724) | (6,576) | (33,137) | (32,138) |
| Miscellaneous income, net | 6,357 | 5,540 | 20,446 | 17,931 |
| Earnings (loss) before income taxes | $189,215 | $ (91,451) | $ 551,481 | $ 214,060 |

Total assets and goodwill by division are as follows:

| *(In thousands)* | Total Assets | | Goodwill | |
|---|---|---|---|---|
| | **September 30, 2006** | **December 31, 2005** | **September 30, 2006** | **December 31, 2005** |
| North American Retail Division | $1,830,572 | $1,714,428 | $ 2,048 | $ 1,952 |
| North American Business Solutions Division | 1,210,684 | 970,667 | 328,688 | 190,532 |
| International Division | 2,578,224 | 2,278,030 | 788,964 | 688,698 |
| Total reportable segments | 5,619,480 | 4,963,125 | 1,119,700 | 881,182 |
| Other | 781,793 | 1,135,400 | | |
| Total | $6,401,273 | $6,098,525 | $1,119,700 | $881,182 |

The change in goodwill for 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. During third quarter 2005, we recorded approximately $237 million of charges related to these activities. These charges consisted primarily of asset impairments, contract terminations and lease adjustments as well as other charges, including inventory clearance, accelerated depreciation and one-time termination benefits. The asset impairments, which are presented separately on the Condensed Consolidated Statements of Earnings, totaled approximately $122 million and related to certain former Kids R Us retail store locations and the impairment of goodwill and other intangible assets related to our Tech Depot subsidiary. Contract terminations and lease adjustments primarily resulted from both the closure of certain retail store locations as well as the termination of several surplus property leases. We also wrote down or accelerated depreciation on assets based on changes in their future use and recognized severance-related charges for the personnel impacts of streamlining activities.

We 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 and Form 10-Q filings with the SEC. As with any estimate, the amounts of future charges 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 third quarter and year-to-date 2006, we recorded approximately $5 million and $32 million, respectively, of charges related to these previously-identified activities (the Third Quarter 2006 Charges and the Year-To-Date 2006 Charges ). These charges were primarily associated with consolidation and streamlining activities. Third Quarter and Year-To-Date Charges are included, as appropriate, in cost of goods sold and occupancy costs, store and warehouse operating and selling expenses, and general and administrative expenses.

The following table summarizes the Year-To-Date Charges by type of activity and changes in liability balances. Certain previously disclosed amounts have been regrouped to conform to the following presentation.

| *(In millions)* | Beginning Balance at 1/1/06 | Charge incurred | Cash payments | Non-cash settlements | Currency and Other Adjustments | Ending Balance at 9/30/06 |
|---|---|---|---|---|---|---|
| One-time termination benefits | $ 6 | $20 | $16 | $ | $ | $ 10 |
| Lease and contract obligations | 23 | 2 | 8 | | 2 | 19 |
| Other asset write offs and accelerated depreciation | | 7 | | 7 | | |
| Other associated costs | 2 | 3 | 2 | | (1) | 2 |
| Total | $ 31 | $32 | $26 | $ 7 | $ 1 | $ 31 |

**Note H Pension Disclosures**

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

| *(In millions)* | **Third Quarter** | | **Year-to-Date** | |
|---|---|---|---|---|
| | **2006** | **2005** | **2006** | **2005** |
| Service cost | $ 2.0 | $ 1.5 | $ 6.0 | $ 5.4 |
| Interest cost | 3.0 | 2.1 | 8.7 | 7.4 |
| Expected return on plan assets | (2.0) | (1.6) | (5.9) | (5.6) |
| Net periodic pension cost | $ 3.0 | $ 2.0 | $ 8.8 | $ 7.2 |

For the quarter and year-to-date periods ended September 30, 2006, we have contributed approximately $1 million and $3 million, respectively, to our foreign pension plans. The Company is evaluating certain plan modifications that could impact future periods.

**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 anc 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 third quarter results are provided below and further discussed in the narrative that follows this overview.

Third quarter sales grew 10% to $3.9 billion when compared to the third quarter of 2005. Sales in North America were up 10%, while International sales increased 13% in U.S. dollars and 9% in local currencies. North American Retail Division comparable store sales were up 3% for the quarter.

Total Company sales for year-to-date 2006 grew 6% to $11.2 billion compared to year-to-date 2005. North American Retail comparable store sales increased 2% for year-to-date 2006.

As part of our previously announced streamlining activities, we recorded $5 million of charges in the third quarter of 2006 (the Third Quarter 2006 Charges ) and an aggregate of $32 million of charges for year-to-date 2006 (the Year-To-Date 2006 Charges ). These projects are expected to continue throughout 2006 and future years. Additional charges related to these projects will be recorded when the related accounting recognition criteria are met.

During the third quarter of 2005, we recognized $237 million of charges related to asset impairments, exit costs and other operating decisions (the Third Quarter 2005 Charges ).

Gross profit as a percentage of sales for the third quarter of 2006 was 30.8%, compared to 30.0% for the same period in 2005. The comparison reflects gross margin improvement of 30 basis points, as well as approximately 50 basis points from Third Quarter 2005 Charges.

Total operating expenses as a percent of sales for the third quarter of 2006 were 25.8% compared to 32.7% for the same quarter of the prior year. Third Quarter Charges impacted the 2006 quarter by approximately 10 basis points and the 2005 quarter by approximately 620 basis points. After considering the Charges, the 80 basis point improvement reflects leverage from increased sales and cost efficiencies.

Net earnings for the quarter were $133 million compared to a net loss of $48 million in the same quarter of the prior year, and diluted earnings per share were $0.47 in the third quarter of 2006 versus a per share loss of ($0.15) in the same period a year ago. After-tax Third Quarter Charges negatively impacted EPS by $0.02 in 2006 and $0.50 in 2005.

During the third quarter of 2006 we completed the acquisition of Papirius, one of the largest business-to-business suppliers of office products and services in Eastern Europe. Additionally, the acquisitions of Allied Office Products and Best Office, as well as the increase in our investment in Office Depot Israel have been consolidated since the related purchases were completed during the second quarter of 2006 but their impacts were not material to our results.

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

During the third quarter and year-to-date 2006 periods, we acquired approximately 5 million shares and 24 million shares, respectively, of our common stock under publicly announced share repurchase programs.

**Charges and Division Results**

Other companies may charge more or less General and Administrative ( 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.

We continually assess our financial reporting practices and strive to provide meaningful and transparent communication of our results. Earlier this year, we initiated a process of allocating to our Divisions G&A expenses that we identified as directly or closely attributable to those operations and we recast our prior period results to provide for an appropriate comparison. As noted above, we recognized significant Charges in the third quarter of 2005. During that quarter, we also indicated that additional charges of a similar nature related to certain actions taken or initiated during that quarter would be recognized as the related accounting criteria are met, in some cases over several years as projects are fully implemented. Management initially evaluated Division operating performance both excluding and including the impact of those Charges recognized during the related periods. Measurement exclusive of the Charges is now the financial performance information our chief operating decision maker uses to assess performance of the Divisions for the purposes of resource allocation. We believe this measure is an appropriate and useful indicator of the effectiveness of current management activities. Accordingly, for segment reporting purposes, we have modified our measurement of Division operating profit to conform to this management view of performance and have recast prior period results for meaningful comparison. No change has been made to total Company operating profit. We will continue to review our internal financial reporting measures and modify our disclosures as appropriate. For example, we are evaluating the merits of presenting distribution costs as operating expenses or cost of sales.

The Third Quarter Charges and Year-To-Date Charges for 2006 and 2005 are included in the following lines in our Condensed Consolidated Statements of Earnings.

| *(In millions)* | **Third Quarter** | | **Year-to-Date** | |
|---|---|---|---|---|
| | **2006** | **2005** | **2006** | **2005** |
| Cost of goods sold and occupancy costs | $ | $ 18 | $ 1 | $ 18 |
| Store and warehouse operating and selling expenses | 3 | 80 | 25 | 80 |
| Asset impairments | | 122 | | 122 |
| General and administrative expenses | 2 | 17 | 6 | 17 |
| Total Charges | $5 | $237 | $32 | $237 |

For additional discussion of these Charges, please see our 2005 Annual Report on Form 10-K and Form 10-Q filings with the SEC, as well as Note G to our Condensed Consolidated Financial Statements included elsewhere in this report. The total of Charges to date is approximately $314 million. We anticipate recognizing an additional $29 million in 2006, $52 million in 2007 and $20 million in 2008, bringing the total currently estimated to $415 million. As with any estimate, the timing and 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.

*North American Retail Division*

| | Third Quarter | | Year-to-Date | |
|---|---|---|---|---|
| *(Dollars in millions)* | **2006** | **2005** | **2006** | **2005** |
| Sales | $1,767.9 | $1,635.9 | $5,066.2 | $4,785.2 |
| % change | 8% | 10% | 6% | 8% |
| | | | | |
| Division operating profit | $ 120.3 | $ 107.9 | $ 351.5 | $ 291.0 |
| % of sales | 6.8% | 6.6% | 6.9% | 6.1% |

Third quarter and year-to-date sales in the North American Retail Division increased 8% and 6%, respectively, compared to the same periods last year. Comparable store sales in the 998 stores in the U.S. and Canada that have been open for more than one year increased 3% in the third quarter and 2% for the year-to-date period. The third quarter of 2006 represents the eleventh consecutive quarter of positive comparable sales led by strength in the technology product category and back to school season. Comparable average ticket size continued to increase and average sales per square foot were $259 for the third quarter.

The North American Retail Division had an operating profit of $120 million for the third quarter of 2006, up from $108 million in the same period of the prior year. 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. During the quarter, we accelerated our pace of remodeling and store expansions by opening 50 new stores (76 year-to-date) and remodeling 64 stores (113 year-to-date). These retail initiatives raised operating expenses by 70 basis points compared to the third quarter of the prior year. Despite these cost pressures, operating profit margin improved 20 basis points to 6.8% in the quarter from 6.6% in the prior year period.

Inventory per store was $923 thousand as of the end of the third quarter of 2006, relatively consistent with the prior year.

At the end of the third quarter, Office Depot operated a total of 1,121 office products stores throughout the U.S. and Canada. Our current plans are to open approximately 110 to 115 stores this year. We also anticipate opening approximately 150 stores in 2007 and 200 additional stores in 2008. In the third quarter, we accelerated our remodel effort and now plan to complete approximately 165 to 175 stores this year with a goal of remodeling all remaining stores in the next two 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*

| | Third Quarter | | Year-to-Date | |
|---|---|---|---|---|
| *(Dollars in millions)* | **2006** | **2005** | **2006** | **2005** |
| Sales | $1,207.7 | $1,080.9 | $3,466.3 | $3,197.8 |
| % change | 12% | 5% | 8% | 5% |
| Division operating profit | $ 96.8 | $ 82.1 | $ 295.4 | $ 243.1 |
| % of sales | 8.0% | 7.6% | 8.5% | 7.6% |

Third quarter and year-to-date sales in the North American Business Solutions Division increased 12% and 8%, respectively, compared to the same periods last year. This Division experienced growth in key product categories, and Division average order values and transactions increased compared to the third quarter of 2005. Third quarter 2006 revenue reflects strong organic growth in our contracts sales channel, as well as a full quarter of the revenue from Allied Office Products, a contract stationer that we acquired during the second quarter of 2006. This growth more than offset declines experienced in our direct selling channel as we executed our brand consolidation in this Division and deliberately reduced some unprofitable business.

Division operating profit margins improved for third quarter and year-to-date 2006. This improvement resulted from slight gross margin expansion, as well as cost savings and operating efficiencies. Division results also reflect costs associated with the continued investment in the expansion of our contract sales force and certain short-term costs associated with the integration of our Allied acquisition. Our supply chain continued its history of improvements in operating expense leverage.

*International Division*

| | Third Quarter | | Year-to-Date | |
|---|---|---|---|---|
| *(Dollars in millions)* | **2006** | **2005** | **2006** | **2005** |
| Sales | $881.6 | $776.9 | $2,635.2 | $2,579.0 |
| % change | 13% | (4)% | 2% | (1)% |
| Division operating profit | $ 55.2 | $ 41.6 | $ 169.1 | $ 150.4 |
| % of sales | 6.3% | 5.4% | 6.4% | 5.8% |

Third quarter and year-to-date sales in the International Division increased 13% and 2%, respectively, compared to the same periods last year. The third quarter of 2006 represents the third straight quarter of sales growth in local currencies and is attributable to both organic growth and to revenue from acquisitions completed during the second and third quarters of 2006. The change in exchange rates from the corresponding prior year period favorably impacted sales reported in U.S. dollars by approximately $33 million for the quarter and unfavorably impacted sales by approximately $56 million for the year-to-date period, compared to the same periods in 2005.

Division operating profit margin expanded approximately 90 basis points for the third quarter and 60 basis points for the year-to-date 2006, compared to the same periods in 2005, due to continued improvements in operating activities coupled with stabilization of gross margins.

At the end of August 2006, we completed the acquisition of Papirius s.r.o, one of the largest business-to-business suppliers of office products and services in Eastern Europe. Papirius has annual revenues of more than $56 million and operations in the Czech Republic, Lithuania, Hungary, and Slovakia. 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 third quarter and for the portion of the second quarter after the acquisition dates but were not material to Division operating income in the quarter. In late September 2006, we announced that we reached a definitive agreement to acquire a majority stake in AsiaEC, an office supply company in China with annual sales of approximately $40 million. This transaction will be included in our results following the closing on October 12, 2006. We intend to continue to seek our opportunities to expand our international operations which provides opportunity for organic growth in these emerging markets, and importantly, provides the footprint to support the needs of our global customers.

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.

During 2006, we have continued to consolidate and enhance our supply chain operations in Europe.

*Corporate and Other*

*General and Administrative ( G&A ) Expenses:* 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 includes Year-To-Date Charges of $6 million and $17 million for 2006 and 2005, respectively. After considering the Charges, corporate G&A expenses as a percentage of sales decreased during the third quarter and the year-to-date 2006 compared to the same periods of 2005 reflecting current cost control and the comparison to certain retention and incentive programs that were recognized in 2005.

*Other Income Taxes:* Our effective tax rate for the third quarter and the year-to-date 2006 was 29.6% and 30.9%, 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 approximately 30%, though unforeseen events may impact the actual rate experienced. Third quarter 2005 income taxes included approximately $7 million of tax expense on additional foreign earnings repatriation, offset by the positive impact of approximately $22 million from adjustments to our accrual for uncertain tax positions based on the closure of various world-wide audits.

*Interest Expense* The increase in interest expense for the third quarter of 2006 compared to the same period in 2005 reflects the positive impact in the prior year from closure of the income tax audits addressed above.

*Interest Income* The decrease in interest income during 2006 reflects lower average cash balances partially offset by higher earnings rates.

**LIQUIDITY AND CAPITAL RESOURCES**

At September 30, 2006, we had approximately $329 million of cash and cash equivalents, as well as $601 million of available credit under our revolving credit facility. The credit availability reflects outstanding borrowings, as well as coverage of $84 million of outstanding letters of credit. We had an additional $41 million of letters of credit outstanding under separate 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 year-to-date 2006, cash provided by operating activities was $792 million compared to $414 million during the same period last year. This change is primarily attributable to improved profitability as well as working capital improvements, including the timing of cash payments.

Cash used in investing activities was $393 million in year-to-date 2006 compared to $243 million in the same period last year. This increase was primarily the result of the acquisitions we completed during the second and third quarters of 2006. The use of cash for year-to-date 2006 also reflects capital expenditures from the opening and relocation of a total of 76 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 64 new stores and five relocations in North America as well as the net purchase of short-term investments. We anticipate capital spending of around $425 million in 2006. For the next two years, we expect capital expenditures of between $600 and $700 million which reflects higher levels of store openings and remodels as well as spending on our supply chain.

Cash used in financing activities was $777 million in year-to-date 2006 compared to $341 million during the same period in 2005. Open market purchases of our common stock totaled $871 million and payments on long- and short-term borrowings totaled $33 million. These uses of cash were partially offset by proceeds from issuance of common stock under our employee related plans of $90 million, as well as $36 million in tax benefits from employee exercises of share-base 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 Pronouncements

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 completed our analysis of the impact this Interpretation will have on our financial condition, results of operations, cash flows or disclosures.

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

The FASB also issued in September 2006 Statement of Financial Accounting Standards No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statement No. 87, 88, 106 and 132(R),* ( FAS 158 ). This Standard requires recognition of the funded status of a benefit plan in the statement of financial position. The Standard also requires recognition in other comprehensive income certain gains and losses that arise during the period but are deferred under pension accounting rules, as well as modifies the timing of reporting and adds certain disclosures. FAS 158 provides recognition and disclosure elements to be effective as of the end of the fiscal year after December 15, 2006 and measurement elements to be effective for fiscal years ending after December 15, 2008. We have not yet analyzed the impact FAS 158 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 September 30, 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 September 30, 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. Already this year we have entered three new international markets and increased our stake in a fourth country to a majority ownership position. 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, the potential for 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™ 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. Because of the limited numbers of ports through which goods may be imported into the United States (located primarily on the West Coast), we are subject to potential disruption of our supplies of goods for resale due to labor unrest, security issues or natural disasters affecting any or all of these ports. 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 number 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 third quarter of the 2006 fiscal year:

| Period | (a) Total Number of Shares Purchased | (b) Average Price Paid per Share | (c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs(1) | (d) Maximum Number of Shares (or Approximate Dollar Value) that May Yet Be Purchased Under the Plans or Programs |
|---|---|---|---|---|
| July 2, 2006 July 29, 2006 | | | | $500,000,000 |
| July 30, 2006 August 26, 2006 | 2,703,400 | $37.08 | 2,703,400 | $399,747,733 |
| August 27, 2006 September 30, 2006 | 2,568,730 | $38.93 | 2,568,730 | $299,747,773 |
| Total | 5,272,130 | $37.98 | 5,272,130 | $299,747,773 |

(1) 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.

**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.<br>(Registrant) |
| Date: October 17, 2006 | By: /s/ Steve Odland<br>Steve Odland<br>Chief Executive Officer and Chairman, Board of Directors (Principal Executive Officer) |
| Date: October 17, 2006 | By: /s/ Patricia McKay<br>Patricia McKay<br>Executive Vice President and Chief Financial Officer (Principal Financial Officer) |
| Date: October 17, 2006 | By: /s/ Jennifer Moline<br>Jennifer Moline<br>Senior Vice President, Finance and Controller (Principal Accounting Officer) |