

OFFICE DEPOT INC
Form 10-K/A
November 20, 2007

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
FORM 10-K/A
Amendment No. 1

(Mark One)

Annual Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934
For the fiscal year ended December 30, 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)
Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
---------------------	--

Common Stock, par value \$0.01 per share	New York Stock Exchange
Securities registered pursuant to Section 12(g) of the Act: None	

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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.

Large accelerated filer Accelerated filer Non-accelerated filer

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

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The aggregate market value of voting stock held by non-affiliates of the registrant as of July 1, 2006 (based on the closing market price on the Composite Tape on June 30, 2006) was approximately \$10,701,900,404 (determined by subtracting from the number of shares outstanding on that date the number of shares held by directors and officers of Office Depot, Inc.).

The number of shares outstanding of the registrant's common stock, as of the latest practicable date: At October 27, 2007, there were 272,972,896 outstanding shares of Office Depot, Inc. Common Stock, \$0.01 par value.

Documents Incorporated by Reference:

Portions of our Proxy Statement for the Annual Meeting held on April 25, 2007, are incorporated by reference in Part III hereof.

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**OFFICE DEPOT, INC.
FORM 10-K/A
INTRODUCTORY NOTE**

This Amendment No. 1 to the annual report on Form 10-K/A (Form 10-K/A) is being filed to amend the company s annual report on

Form 10-K for the year ended December 30, 2006, which was originally filed on February 14, 2007 (Original Form 10-K).

On October 29, 2007, Office Depot announced that its Audit Committee initiated an independent review principally focused on the accounting for certain vendor program funds. The review, which arose from a whistleblower complaint, was conducted with the assistance of independent legal counsel and forensic accountants. The investigation revealed errors in the timing of recognition of certain vendor program funds. The impact of these errors is to reduce previously reported gross profit, operating profit, net earnings and earnings per share in fiscal 2006 and the first two quarters of 2007 and defer recognition into future periods. Additionally, inventories and tax accounts have been adjusted on the consolidated balance sheet related to these deferrals.

As a result of the Audit Committee s review, on November 8, 2007, the Board of Directors of the company approved a decision to restate the company s 2006 financial statements including corrections to amounts previously reported in the third and fourth quarters of 2006 and the interim financial statements for the first and second quarters of 2007. The company is hereby amending its previously filed Form 10-K for the fiscal year 2006 and concurrently will file amended Forms 10-Q for the first and second quarters of 2007. We do not anticipate filing any amended Forms 10-Q for 2006. The financial statements and related disclosures for the period ended September 30, 2006 have been restated in the company s Form 10-Q for the quarter ended September 29, 2007 to reflect the impact of the errors discussed above. This Form 10-K/A amends and restates:

Part I Item 1A. Risk Factors

Part II Item 6. Selected Financial Data

Part II Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

Part II Item 8. Financial Statements and Supplementary Data
Management s Report in Internal Controls Over Financial Reporting

Reports of Independent Registered Public Accounting Firm

Consolidated Balance Sheets

Consolidated Statements of Earnings

Consolidated Statements of Stockholders Equity

Consolidated Statements of Cash Flows

Notes to Consolidated Financial Statements the impacts are more fully discussed in Note B Results of Audit Committee Independent Review and Restatement of Financial Statements

Part II Item 9A. Controls and Procedures

We are also updating the Signature Page and certifications of our Chief Executive and Chief Financial Officers on Exhibits 31.1, 31.2 and 32.

This Form 10-K/A does not reflect events occurring after the filing of the Original Form 10-K, other than the restatement for the matter discussed above. Such events include, among others, the events described in the company s

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Office Depot, Inc. is a global supplier of office products and services. The company was incorporated in 1986 with the opening of our first retail store in Fort Lauderdale, Florida. In fiscal year 2006, we sold \$15.0 billion of products and services to consumers and businesses of all sizes through our three business segments: North American Retail Division, North American Business Solutions Division and International Division. Sales are processed through multiple channels, consisting of office supply stores, a contract sales force, internet sites, direct marketing catalogs and call centers, all supported by our network of crossdocks, warehouses and delivery operations.

Additional information regarding our business segments is presented below and in Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) elsewhere in this Annual Report on Form 10-K/A.

North American Retail Division

Our North American Retail Division sells a broad assortment of merchandise, including brand name and private brand office supplies (Office Depot® brand and other proprietary brands), business machines and computers, computer software, office furniture and other business-related products and services through our chain of office supply stores. Most stores also contain a design, print and ship center offering graphic design, printing, reproduction, mailing, shipping, and other services.

Our retail stores are designed to provide a positive shopping experience for the customer, supported by an effective and efficient supply chain. We strive to optimize visual presentation, product placement, shelf capacity, in-stock positions, and inventory turnover, as well as our distribution capacity and handling costs. Our goal is to maintain sufficient inventory in the stores to satisfy customer needs, while controlling the overall working capital invested in inventory. Currently, most store replenishment is handled through our crossdock flow-through distribution system. Bulk quantities of vendor merchandise are received at one of our central locations, sorted for distribution and generally shipped the same day to stores needing to replenish their inventory.

In recent years, we have developed a new store format that we call M2. This design is intended to enhance the overall shopping experience for customers by providing improved lines of sight, more effective product adjacencies, and updated signage and lighting, while lowering overall operating costs. This format is being used for all new store openings and remodels. In 2006, we completed remodeling 176 stores, and we expect to remodel all remaining stores in the next two to three years. While we believe the current M2 format is a desirable design and an improvement over prior designs, we expect to continue to optimize it in the future.

At the end of 2006, our North American Retail Division operated 1,158 office supply stores throughout the U.S. and Canada. The largest concentration of our retail stores is in California, Texas and Florida, but we have broad representation across North America. The count of open stores may include locations temporarily closed for remodels or other factors. The 2005 count includes five locations that were being restored following hurricane damage. Store opening and closing activity for the last three years has been as follows:

	Open at Beginning of Period	Opened	Closed	Open at End of Period	Relocated
2004	900	80	11	969	11
2005	969	100	22	1,047	6
2006	1,047	115	4	1,158	7

We plan to continue our store expansion by adding approximately 150 new retail stores in 2007 and 200 additional stores in 2008. In recent years, we have launched initiatives into non-traditional retail selling, such as providing our products for sale within other retailers' locations. We expect to continue to pursue various types of non-traditional solutions over time to expand the reach of our products and services.

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North American Business Solutions Division

We have provided office supply products and services directly to businesses through our delivery operations for over twelve years. In 1998, we expanded our catalog business and strengthened our international operations through our merger with Viking Office Products (Viking), a company that sold from catalogs and operated customer call centers in the United States and in several European countries. In 2005, we announced our intention to combine the Office Depot and Viking catalog offerings and, effective in 2006, we stopped marketing the Viking brand in the United States. We continue to use the Viking brand for direct marketing to customers in our International Division. In 2006, we acquired Allied Office Products, an independent dealer of office products and services. This acquisition strengthened our position in the Northeast part of the United States while bringing us expertise and relationships in the important vertical markets of healthcare and legal. Integration of this acquisition was substantially complete as of the end of 2006.

Our North American Business Solutions Division sells branded and private brand products and services by means of a dedicated sales force, through catalogs and electronically through our internet sites. We strive to ensure that our customers' needs are satisfied through the method of delivery that they want, and continue to develop the systems and processes to enable us to do so efficiently and effectively. Our direct business is tailored to serve small- to medium-sized customers. Our direct customers can order products from our catalogs, by phone or through our public web sites (www.officedepot.com), including our public web site for technology purchases (www.techdepot.com). Our contract business employs a dedicated sales force that services the office supply needs of medium-sized to Fortune 100 customers. We believe sales representatives increase revenues by building relationships with customers and providing information, business tools and problem-solving services to them. We also allow contract customers the convenience of shopping on dedicated web sites and in our retail locations, while honoring their contract pricing. Sales made at retail locations to our contract customers are included in the results of our North American Retail Division.

Contract and direct customers' orders are filled primarily through our Distribution Centers (DCs) located across the United States. Some DCs also house sales offices and administrative offices. We have outsourced our call center activities; however, in-house staff manage the most critical points of customer interaction. During 2007, we will continue to identify ways to service our customers with greater efficiency and effectiveness.

Inventory is held in our DCs at levels we believe sufficient to meet current and anticipated customer needs. We utilize processes to evaluate the appropriate timing and quantity of reordering with the objective of controlling our investment in inventory, while at the same time ensuring customer satisfaction. Certain purchases may be sent directly from the manufacturer to our customers. We regularly review our inventory for slow moving or obsolete items and adjust our inventory levels accordingly.

Over the past several years, we have implemented advanced technologies to assist with reordering, stocking, the pick-and-pack process and delivery operations. We have also increased our use of third party delivery services and reduced our own fleet of vehicles where cost reductions can be achieved without compromising customer service levels. As a result of these and other initiatives, supply chain costs have continued to decline in recent years. We operated 20 DCs at the end of 2006. We intend to continue to focus on our supply chain operations to better serve our customers and reduce costs.

Because sales and marketing efforts and catalog production have similarities between the North American Business Solutions Division and the International Division, those topics are addressed separately after the three segment discussions, though they are integral to understanding the processes and management of these Divisions.

International Division

We sell to customers in 42 countries throughout North America, Europe, Asia and Latin America either through wholly-owned entities, majority-owned entities or other ventures covering 34 countries, and through alliances in an additional 8 countries. The International Division sells office products and services through direct mail catalogs, contract sales forces, internet sites and retail stores, using a mix of company owned operations, joint ventures, licensing and franchise agreements, alliances and other arrangements. International operations are managed on a geographic basis through three regional offices rather than by sales channel; however, for consistency of discussion, sales channels will be used to describe the activities of the International Division.

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During 2006, we continued to review our methods of operating internationally and identified certain functions and operations that we believe can be more efficiently operated if combined or centralized. Furthermore, we have chosen to strategically align the manner and scope of our business activities on a global basis, while allowing for localization where appropriate. The activities to implement these plans have had an impact on our results for 2006 and are addressed further in MD&A.

The international direct channel was launched in 1990 under the Viking Direct® brand with the start-up of operations in the United Kingdom. We now have catalog offerings in 11 countries outside of North America. In March 1999, we introduced our first international public internet site for consumers and businesses in the United Kingdom. Today, we operate over 30 separate web sites in the International Division.

In June 2003, we further expanded our contract start-up business with the acquisition of Guilbert, S.A. The acquisition of Guilbert added European-wide purchasing power and scale to the International Division. Guilbert operations and customers are now fully integrated into the Office Depot and Viking operations, and as of the end of 2006, we no longer operate under the Guilbert trade name.

We have been selective about opening retail stores internationally. At the end of 2006, the International Division operated through wholly-owned or majority-owned entities, 125 stores in France, Japan, Hungary, Israel and South Korea. In addition, 153 retail stores were operated under the Office Depot brand name under various licensing and joint venture agreements in Costa Rica, El Salvador, Guatemala, Honduras, Panama, Mexico, and Thailand. We also participate in 70 franchised stores in South Korea, bringing our total number of stores outside North America to 348. In 2007, the International Division expects to open over 20 stores through company-owned and majority-owned entities.

We are continuously assessing opportunities to expand our geographic footprint around the globe. During the second quarter of 2006, we acquired a controlling interest in Best Office in South Korea and increased our ownership interest to a majority stake in Office Depot Israel. In August 2006, we completed the acquisition of Papius s.r.o., one of the largest business-to-business suppliers of office products and services in Eastern Europe. In October 2006, we acquired a majority stake in AsiaEC, one of the largest suppliers of office products and services in China. To appropriately support our geographic expansion, the International Division operates regional headquarters for Europe/Middle East and Asia and is developing a regional headquarters for Latin America.

International Division store and Distribution Center operations are summarized below (includes only wholly-owned and majority-owned entities):

	Office Supply Stores			
	Open at Beginning of Period	Opened/ Acquired	Closed	Open at End of Period
2004	64	15 ⁽¹⁾	1	78
2005	78	6	14	70
2006	70	55⁽²⁾		125
	Distribution Centers			
	Open at Beginning of Period	Opened/ Acquired	Closed	Open at End of Period
2004	25	2 ⁽³⁾	2 ⁽⁴⁾	25
2005	25	3 ⁽⁵⁾	3	25
2006	25	10⁽⁶⁾	3	32

- (1) Includes three retail stores obtained in the acquisition of the business in Hungary.
- (2) Includes 33 retail stores obtained in the acquisition of the business in Israel and nine retail stores obtained in the acquisition of the business in South Korea.
- (3) Includes one DC obtained in the acquisition of the business in Hungary.
- (4) Represents updates to the Guilbert post-integration estimates.
- (5) Includes two DCs that were previously excluded as planned post-integration closures.
- (6) Includes one DC obtained in the acquisition of the business in Israel, five DCs obtained in the acquisition of the business in China, one DC obtained in the acquisition

of the business
in South Korea
and two DCs
obtained in the
acquisition of
Papirus that are
located in the
Czech Republic
and Lithuania.

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Our merchandising strategy is to meet our existing and target customers' needs by offering a broad selection of branded office products, including an increasing array of private brand products and services. Our selection of private brand products has increased in breadth and level of sophistication over time. We currently offer general office supplies, computer supplies, business machines and related supplies, and office furniture under various labels, including Office Depot®, Office Depot Value®, Viking Office Products®, Niceday®, Foray®, Ativa®, Break Escapes®, Worklife® and Christopher Lowell®.

Total sales by product group were as follows:

	2006	2005	2004
Supplies	60.8%	61.3%	62.1%
Technology	26.1%	25.6%	24.4%
Furniture and other	13.1%	13.1%	13.5%
	100.0%	100.0%	100.0%

We buy substantially all of our merchandise directly from manufacturers and other primary suppliers, including direct sourcing of products from domestic and offshore sources. We also enter into arrangements with vendors that can lower our unit product costs if certain volume thresholds or other criteria are met. For additional discussion of these arrangements, see the Critical Accounting Policies section of MD&A. In most cases, our suppliers deliver merchandise directly to our DCs or crossdocks. The latter are centralized distribution centers for re-supplying our retail stores to facilitate low handling and freight costs.

We operate separate merchandising functions in North America, Europe and Asia as well as in our joint ventures. Each group is responsible for selecting, purchasing and pricing merchandise as well as managing the product life cycle of our inventory.

Sales and Marketing

Our marketing programs are designed to attract new customers and to drive frequency of customer visits to our stores and web sites and increase the share of wallet of our existing customers by capturing more of what they spend in total on the products we sell. We regularly advertise in major newspapers in most of our North American markets. These advertisements are combined with local and national radio, network and cable television advertising campaigns, direct marketing efforts and sports sponsorships.

To enhance our brand awareness, we announced two new strategic marketing initiatives at the beginning of 2005. First, we re-launched the *Taking Care of Business* campaign. We also launched the sponsorship of a NASCAR® race car, and in 2006, we expanded our sponsorship of our NASCAR® race car to include a full season. We are currently designated NASCAR®'s official office products partner.

We also offer customer loyalty programs that provide customers with rewards that can be applied against future Office Depot purchases or other incentives. These programs have provided us with valuable information enabling us to market more effectively to our customers and drive incremental sales. These programs may change in popularity in the future, and we may make alterations to them from time to time.

We perform periodic competitive pricing analyses to monitor each market, and prices are adjusted as necessary to adhere to our pricing philosophy and further our competitive positioning. We generally expect our everyday prices to be highly competitive with other resellers of office products.

We continuously acquire new customers by selectively mailing specially designed catalogs and by making on-premises sales calls to prospective customers. We also make outbound sales calls using dedicated agents. We obtain the names of prospective customers in new and existing markets through the purchase of selected lists from outside marketing information services and other sources as well as through the use of a proprietary mailing list system.

No single customer in any of our segments accounts for more than 5% of our total sales.

We consider our business to be only somewhat seasonal, with sales slightly lower in the second quarter. Certain working capital components may build and recede during the year reflecting established selling cycles, but we do not consider the company to be highly-seasonal.

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Catalogs

We use catalogs to market directly to both existing and prospective customers throughout our operations globally. Each catalog is printed with pictures and narrative descriptions that emphasize key product benefits and features. We have developed a distinctive style for our catalogs, most of which are produced in-house by our designers, writers and production artists. We also produce a Green Book® catalog, which features products that are recyclable, energy efficient, or otherwise have a reduced impact on the environment. We continually evaluate our catalog offerings for efficiency and effectiveness.

Our catalog offerings typically include a complete buyers' guide containing all of our products at their regular discount prices delivered to our customers every six months. This buyers' guide, which is distributed to our active customers, varies in size among countries. Prospecting catalogs with special offers designed to attract new customers are mailed frequently. In addition, specialty catalogs may be delivered more frequently to selected customers.

Industry and Competition

We operate in a highly competitive environment. We believe that we compete favorably on the basis of price, service, relationships and selection. We compete vigorously with office supply stores, wholesale clubs, discount stores, mass merchandisers, food and drug stores, computer and electronics superstores, internet-based companies and direct marketing companies. These companies, in varying degrees, compete with us in substantially all of our current markets.

Other office supply retail companies market similarly to us in terms of store format, pricing strategy and product selection and availability in the markets where we operate, primarily those in the United States and Canada. We anticipate that in the future we will face increased competition from these chains as each of us expands our operations locally and globally.

Internationally, we compete on a similar basis to how we compete in North America. Outside of the U.S. and Canada, we sell through contract and catalog channels in 18 countries and operate retail stores in five countries through wholly-owned or majority-owned entities. Additionally, our International Division provides office products and services in 22 countries through joint ventures, licensing and franchise agreements, cross-border transactions, alliances and other arrangements.

Employees

As of January 28, 2007, we had approximately 52,000 employees worldwide, with almost half of these employed as part-time workers. Our labor relations are generally good, and the overwhelming majority of our facilities are not organized by labor unions.

Environmental Activities

As both a significant user and seller of paper products, we have developed environmental practices that are values-based and market-driven. Our environmental initiatives center on three guiding principles: (1) recycling and pollution reduction; (2) sustainable forest management; and (3) issue awareness and market development for environmentally preferable products. We offer thousands of different products containing recycled content, including from 35% to 100% post consumer waste content paper.

In 2006, Office Depot undertook a number of environmental initiatives to increase our purchase and sale of environmentally preferable products, often referred to as "green" products. We created and executed a comprehensive questionnaire to help us source environmentally preferable papers. This questionnaire was designed by Conservation International, one of the partners in Office Depot's Forest and Biodiversity Conservation Alliance (www.forestryalliance.org). Under this initiative, we rolled out an energy efficient lighting retrofit program across the majority of our stores and facilities. We also purchased 76,000 megawatt hours of renewable energy. We launched our third Green Book catalog in the USA, containing over 2300 environmentally preferable products. We also launched Green Books in Belgium, France, Germany, the Netherlands and the UK. These catalogs are designed to help our customers easily identify our green product range and become more informed green buyers.

To obtain additional information on our initiatives, and to download a copy of Office Depot's 2006 *Environmental Stewardship Report*, please visit our web site at www.officedepot.com/environment. You may also request a printed copy by contacting our Director, Investor Relations at our corporate headquarters in Delray Beach, Florida.

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Available Information

We maintain a web site at www.officedepot.com. We make available, free of charge, on the Investor Relations section of our web site, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act, as soon as reasonably practicable after we electronically file or furnish such materials to the U.S. Securities and Exchange Commission (SEC).

Additionally, our corporate governance materials, including governance guidelines; the charters of the Audit, Compensation, Finance, and Governance and Nominating Committees; and the code of ethical behavior may also be found under the Investor Relations section of our web site [at www.officedepot.com](http://www.officedepot.com). Office Depot makes no provisions for waivers of the code of ethical behavior. A copy of the foregoing corporate governance materials is available upon written request.

We submitted our 2006 annual Section 12(a) CEO certification with the New York Stock Exchange (NYSE). The certification was not qualified in any respect. Additionally, we filed with the SEC as exhibits to our Form 10-K for the year ended December 31, 2005 the CEO and CFO certifications required under Section 302 of the Sarbanes-Oxley Act of 2002.

Executive Officers of the Registrant

Steve Odland Age: 48

Mr. Odland has been Chairman, Chief Executive Officer and a Director since early 2005. Prior to joining Office Depot, Inc., he was Chairman, Chief Executive Officer and President of AutoZone, Inc., from 2001 until 2005. Previously he was an executive with Ahold USA from 1998 to 2000, President of the Foodservice Division of Sara Lee Bakery from 1997 to 1998 and was employed by The Quaker Oats Company from 1981 to 1996 in various executive positions. Mr. Odland is also a director of General Mills, Inc.

Charles Brown Age: 53

Mr. Brown was appointed President, International in early 2005. He remained the company's Executive Vice President and Chief Financial Officer until late 2005, a position he had held since 2001. Prior to that, Mr. Brown was Senior Vice President, Finance, and Controller since he joined our company in 1998. Before joining Office Depot, he was Senior Vice President and Chief Financial Officer of Denny's, Inc. from 1996 until 1998; from 1994 until 1995, he was Vice President and Chief Financial Officer of ARAMARK International; and from 1989 until 1994, he was Vice President and Controller of Pizza Hut International, a Division of PepsiCo, Inc.

Cynthia Campbell Age: 55

Ms. Campbell has been our Executive Vice President, North American Business Solutions Division since 2003. Prior to that, she was Senior Vice President, Contract Sales for the eastern half of the U.S., a position she assumed in 2000. She began her Office Depot career in 1995 as Zone Vice President Southeast Region, with responsibility for contract sales and operations. Prior to joining our company, Ms. Campbell spent 19 years with GTE Corporation in a variety of positions, the latest being Vice President and General Manager of Retail Information Services.

David Fannin Age: 61

Mr. Fannin has been our Executive Vice President, General Counsel and Secretary since 2000. Previously, he was Senior Vice President and General Counsel since he joined our company in 1998, and our Corporate Secretary since 1999. Mr. Fannin was Executive Vice President, General Counsel and Corporate Secretary of Sunbeam Corporation, a manufacturer and wholesaler of durable household and outdoor consumer products, from 1994 until 1998.

Monica Luechtefeld Age: 58

Ms. Luechtefeld has been our Executive Vice President, Business Development, Information Technology and Supply Chain since early 2005. Previously, she was Executive Vice President of E-Commerce from 2000. Prior to this role, she held several officer positions including Vice President, Marketing and Sales Administration and Vice President of Contract Marketing & Business Development. Ms. Luechtefeld joined Office Depot in 1993, serving as General Manager of the Southern California Region of Office Depot until 1996.

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Patricia McKay Age: 49

Ms. McKay has served as our Executive Vice President, Chief Financial Officer since late 2005. From 2004 until 2005 she served as a Director of our company. She served from 2003 as Executive Vice President and Chief Financial Officer of Restoration Hardware, Inc. until she joined our company as CFO in 2005. From 1997 until 2003, she worked in various executive-level positions at AutoNation, Inc., concluding in her serving as Senior Vice President, Finance. From 1988 until 1996, Ms. McKay served in various financial positions for Dole Food Company, Inc., culminating in the position of Vice President Finance and Controller, a position she held from 1993 until 1996. Ms. McKay began her career at a major international public accounting firm where she worked as an auditor for ten years.

Carl (Chuck) Rubin- Age: 47

Mr. Rubin was appointed President, North American Retail in early 2006. Prior to assuming that position, Mr. Rubin held the position of Executive Vice President, Chief Merchandising Officer and Chief Marketing Officer since 2004. Before joining the company, Mr. Rubin spent six years with Accenture Ltd., most recently as Partner, where he worked for clients, including Office Depot, across retail formats in the department, specialty and e-commerce channels, as well as new business startups. Prior to joining Accenture, Mr. Rubin spent six years in specialty retailing and 11 years in department store retailing, where he served as General Merchandise Manager and a member of the Executive Committees for two publicly-held companies.

Daisy Vanderlinde Age: 55

Ms. Vanderlinde was appointed Executive Vice President, Human Resources in late 2005. Prior to joining Office Depot, Ms. Vanderlinde was Senior Vice President, Human Resources and Loss Prevention, for AutoZone Inc. from 2001 to 2005, and was a member of the Executive Committee. Ms. Vanderlinde has also served as a senior HR officer for other retailers, including Tractor Supply Company, Marshalls Inc., and The Broadway Stores.

Jennifer Moline Age: 49

Ms. Moline joined Office Depot in July 2006 and was appointed Senior Vice President and Controller. Prior to joining Office Depot, Ms. Moline served as Vice President, US Finance Operations and as Director of Finance Integration at DHL Express from 2003 to 2006. Previously, Ms. Moline served as Vice President, Accounting Services at ANC Rental Corporation from 2000 to 2003, Ms. Moline was employed at Tupperware Corporation for 11 years from 1989 to 2000 in various positions, the last one being Vice President and Treasurer.

Information with respect to our directors is incorporated herein by reference to information included in the Proxy Statement for our 2007 Annual Meeting of Shareholders.

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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, 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 have retail outlets that allow them to compete directly for copy, printing, packaging and shipping business, and offer products and services similar to ones we offer. While they do not yet offer the breadth of products that we offer, they are extremely competitive in the areas of package shipping and copy and print centers. Recently, the so-called warehouse clubs have expanded upon their in-store offerings by adding catalog and internet sales channels, offering a broad assortment of office products for sale on a direct delivery basis. 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 open approximately 150 stores in the United States and Canada and approximately 20 stores in our International Division during 2007. 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. Business lost during remodeling periods, because of customer inconvenience, or closed periods for individual stores may not be recovered or successfully redirected to other stores in the area. 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. In addition, the business cultures in certain areas of the world are different than those that prevail in the United States, and we may be at a competitive disadvantage against other companies that do not have to comply with standards of financial controls or business integrity that Office Depot is committed to maintaining as a U.S. publicly traded company and SEC registrant. 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.

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Global Sourcing of Products/Private Brand: In recent years, we have substantially increased the number and types of products that we sell under our private brands. We currently offer general office supplies, computer supplies, business machines and related supplies, and office furniture under various labels, including Office Depot®, Office Depot Value™, Viking Office Products®, Niceday™, Foray®, Ativa®, Break Escapes™, Worklife™ and Christopher Lowell™. Sources of supply may prove to be unreliable, or the quality of the globally sourced products may vary from our expectations. We have recently opened our own sourcing office in China and are reducing our reliance on the use of third-party trading companies. While this may improve our cost structure in terms of global sourcing, it also makes our company more accountable for relationships with the factories and other sources of private branded product and increases our risks associated with doing business in that region of the world. Economic and civil unrest in areas of the world where we source such 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 Far East 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 number 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. Finally, as a significant importer of manufactured goods from foreign countries, we are vulnerable to security concerns, labor unrest and other factors that may affect the availability and reliability of ports of entry for the products that we source. 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 manufacturers branded items and are thereby dependent 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 manufacturers' products and cost increases must either be passed along to our customers or result in an 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 our 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 2004 and 2005, we sustained disruption to our businesses in the United States due to the number and severity of weather events in the Southeastern United States, including 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 for a number of years into the future. It is impossible to know whether these storms will occur as forecasted, or the location or severity of such storms. During late 2006 and early 2007, we also sustained business disruption due to ice and snow conditions in the Midwest and Southwest, in areas that also have large concentrations of our business activities, resulting in supply chain constraints and other disruptions in our businesses. We believe that we have taken reasonable precautions to prepare for such weather-related events, but there is no assurance that our precautions will be adequate to deal with such events in the future. If these events occur in the future (as they almost certainly will), and if they should impact areas in which we have concentrations of retail stores or distribution facilities, such events could have a material adverse effect on our business and results of our operations.

New Systems and Technology: We frequently modify our systems and technology to increase productivity and efficiency. We are undertaking certain 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 appropriate to the industry and competitive factors. In recent years, there has been a growing movement to closely monitor compliance with labor laws and regulations, many of which vary from jurisdiction to jurisdiction and can be difficult to adhere to as precisely as some enforcement officials and litigants insist the company should do. This has added to our labor costs in some locales as we have had to add personnel to monitor and track compliance with these sometimes arcane rules and regulations that impact retailers in particular. As a result of these and other factors, we face many external risks and internal factors in meeting our labor needs, including competition for qualified personnel, overall unemployment levels, 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.

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Operating Costs: We operate a large network of stores and delivery 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 our stores and 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. At any given point in time, we base our estimate of an annual effective tax rate upon a calculated mix of the tax rates applicable to our company and to estimates of the amount of income likely to be generated 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, 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.

Regulatory Environment: While all businesses are subject to regulatory matters relating to the conduct of their businesses, including consumer protection laws, advertising regulations, wage and hour regulations and the like, certain jurisdictions have taken a particularly aggressive stance with respect to such matters and have stepped up enforcement, including fines and other sanctions. The company transacts substantial amounts of business in certain such jurisdictions, and to the extent that the company's business locations are exposed to what might be termed an overly aggressive enforcement environment or legal or regulatory systems that authorize or encourage private parties to pursue relief under so-called private attorney general laws and similar authorizations for private parties to pursue enforcement of governmental laws and regulations, the resulting fines and exposure to third party liability (such as monetary recoveries and recoveries of attorneys fees) could have a material adverse effect on our business and results of operations, including the added cost of increased prophylactic measures that the company may determine to be necessary to conduct business in such locales.

Litigation Risks: Litigation and governmental investigations or proceedings arising out of or related to our Audit Committee's internal accounting review could result in substantial costs. See Part II Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations Results of Audit Committee Independent Review and Restatement of Financial Statements. In addition, we could be exposed to enforcement with respect to these matters by the SEC's Division of Enforcement or other regulatory bodies. For a description of pending litigation and governmental proceedings and investigations, see Part II Item 1 Legal Proceedings in our current reports on Form 10-Q/A or Form 10-Q filed concurrent with or subsequent to this filing.

Restatement Risks: In July 2007, the company received a letter of informal inquiry from the SEC, looking into the company's contacts and communications with financial analysts during 2007 as well as certain other matters, including inventory receipt, timing of vendor payments and certain intercompany loans. The SEC expanded its inquiry to include the timing of recognition of vendor program funds after notification by the company of its review of this area. Prior to filing its quarterly report on Form 10-Q for the quarter ended June 30, 2007, the company completed a review of the accounting matters related to inventory receipt, timing of vendor payments and certain intercompany loans, with the assistance of independent forensic accountants. The company, however, is continuing to discuss these issues with the SEC. While it is not anticipated, it is possible that such discussions with the SEC could result in a further restatement of the company's financial statements and amendments to this report or prior annual reports and quarterly

reports.

Material Weakness in Internal Controls: In connection with the Restatement and our reassessment of our internal control over financial reporting pursuant to the rules promulgated by the Commission under Section 404 of the Sarbanes-Oxley Act of 2002 and Item 308 of Regulation S-K, management has concluded that as of December 30, 2006, our disclosure controls and procedures were not effective and that we had a material weakness in our internal control over financial reporting. Please refer to Item 9A of this Form 10-K/A for further discussion of the ineffectiveness of and material weakness in our controls as of December 30, 2006. Should we be unable to remediate such material weakness promptly and effectively, an unresolved weakness could have a material adverse effect on our business, results of operations and financial condition, as well as impair our ability to meet our quarterly, annual and other reporting requirements under the Securities Exchange Act of 1934 in a timely manner. These effects could in turn adversely affect the trading price of our common stock and could result in a material misstatement of our financial position or results of operations and require a further restatement of our financial statements. In addition, even if we are successful in strengthening our controls and procedures, such controls and procedures may not be adequate to prevent or identify control weaknesses.

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 Annual Report to reflect actual results, changes in assumptions or other factors affecting such forward-looking statements.

Item 1B. Unresolved Staff Comments.

None.

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As of January 27, 2007, we operate 1,140 office supply stores in 49 states and the District of Columbia, 29 office supply stores in five Canadian provinces and 125 office supply stores (excluding our participation under licensing and joint venture agreements) in five countries outside of the United States and Canada. The following table sets forth the locations of these facilities. We also operate 20 DCs in 17 U.S. states and 32 DCs in 16 countries outside of the United States.

STORES

State/Country	#	State/Country	#
UNITED STATES:			
Alabama	21	North Dakota	2
Alaska	2	Ohio	16
Arizona	4	Oklahoma	15
Arkansas	10	Oregon	18
California	155	Pennsylvania	25
Colorado	34	Rhode Island	2
Connecticut	6	South Carolina	20
District of Columbia	1	South Dakota	1
Delaware	4	Tennessee	27
Florida	126	Texas	135
Georgia	53	Utah	10
Hawaii	3	Virginia	27
Idaho	6	Washington	35
Illinois	59	West Virginia	3
Indiana	22	Wisconsin	13
Iowa	5	Wyoming	2
Kansas	8	TOTAL UNITED STATES	1,140
Kentucky	19		
Louisiana	35		
Maryland	29	CANADA:	
Maine	2	Alberta	7
Massachusetts	7	British Columbia	9
Michigan	27	Manitoba	2
Minnesota	12	Ontario	9
Mississippi	15	Saskatchewan	2
Missouri	25	TOTAL CANADA	29
Montana	2		
Nebraska	5		
Nevada	16	FRANCE	43
New Hampshire	1	HUNGARY	11
New Jersey	23	ISRAEL	40
New Mexico	5	JAPAN	22
New York	14	SOUTH KOREA	9
North Carolina	33	TOTAL OUTSIDE NORTH AMERICA	125

The table above reflects 11 additional stores opened in the United States during January 2007.

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State/Country	#	State/Country	#
UNITED STATES:			
Arizona	1	BELGIUM	1
California	2	CHINA	5
Colorado	1	CZECH REPUBLIC	1
Florida	2	FRANCE	5
Georgia	1	GERMANY	3
Illinois	1	HUNGARY	1
Louisiana	1	THE NETHERLANDS	2
Maryland	1	IRELAND	2
Massachusetts	1	ISRAEL	1
Michigan	1	ITALY	1
Minnesota	1	JAPAN	1
New Jersey	1	SOUTH KOREA	1
North Carolina	1	LITHUANIA	1
Ohio	1	SPAIN	1
Texas	2	SWITZERLAND	1
Utah	1	UNITED KINGDOM	5
Washington	1		
TOTAL UNITED STATES	20	TOTAL OUTSIDE THE UNITED STATES	32

In addition to the properties identified in the tables above, we operate 10 crossdock facilities in the US. Generally, these facilities serve as centralized same-day distribution facilities where bulk shipments are brought in, broken into smaller quantities and shipped to locations needing supply.

Most of our facilities are leased or subleased, with initial lease terms expiring in various years through 2032, except for 77 facilities, including certain corporate office buildings and our systems data center, which we own. Our owned facilities are located in 24 states, primarily in Florida, Texas and California; two Canadian provinces; the United Kingdom; the Netherlands; and France.

Our corporate offices in Delray Beach, Florida consist of approximately 540,000 square feet in three separate buildings. The facilities were sold in December 2006 and have been leased back for a two-year period while a new facility is under construction. We also own a corporate office in Venlo, the Netherlands which is approximately 226,000 square feet in size, and a systems data center in Charlotte, North Carolina which is approximately 53,000 square feet in size.

Item 3. Legal Proceedings.

We are involved in litigation arising from time to time in the normal course of our business. While from time to time claims are asserted that may make demands for large sums of money, including ones asserted in the form of class action suits, we do not believe that the resolution of any of these matters, either individually or in the aggregate, will materially affect our financial position, cash flows or the results of our operations.

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

None.

Table of Contents**PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.**

Our common stock is listed on the New York Stock Exchange (NYSE) under the symbol ODP. As of the close of business on January 26, 2007, there were 7,075 holders of record of our common stock. The last reported sale price of the common stock on the NYSE on January 26, 2007 was \$37.35.

The following table sets forth, for the periods indicated, the high and low sale prices of our common stock, as quoted on the NYSE Composite Tape. These prices do not include retail mark-ups, markdowns or commission.

	High	Low
2006		
First Quarter	\$38.050	\$30.640
Second Quarter	46.520	36.680
Third Quarter	40.860	33.650
Fourth Quarter	44.690	36.870
2005		
First Quarter	\$23.700	\$16.500
Second Quarter	22.840	18.590
Third Quarter	31.520	21.700
Fourth Quarter	31.760	24.510

We have never declared or paid cash dividends on our common stock. While we regularly assess our dividend policy, we have no current plans to declare a dividend. Earnings and other cash resources will continue to be used in the expansion of our business.

The following table provides information with respect to our purchases of Office Depot, Inc. common stock during the fourth 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
October 1, 2006 - October 28, 2006	2,496,261 ⁽²⁾	\$ 40.99	2,438,670	\$ 199,747,780
October 29 2006 - November 25, 2006	10,051 ⁽³⁾	\$ 41.09		\$ 199,747,780
November 26, 2006 - December 30, 2006				\$ 199,747,780

Total / Balance as of December 30, 2006	2,506,312	\$	40.99	2,438,670	\$	199,747,780
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(1) On May 12, 2006, the board of directors authorized a common stock repurchase program whereby we are authorized to repurchase up to \$500 million of our common stock.

(2) Includes 57,591 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.

(3) Includes 10,051 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.

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The following table sets forth selected consolidated financial data at and for each of the five fiscal years in the period ended December 30, 2006. It should be read in conjunction with the Consolidated Financial Statements and Notes thereto, included in Item 8 of this report, and Management's Discussion and Analysis of Financial Condition and Results of Operations, included in Item 7 of this report.

<i>(thousands, except per share amounts and statistical data)</i>	2006⁽¹⁾ (Restated)	2005 ⁽²⁾	2004	2003 ⁽³⁾⁽⁴⁾	2002 ⁽³⁾⁽⁴⁾
Components of Earnings Data:					
Earnings from continuing operations before cumulative effect of accounting change	\$ 15,010,781	\$ 14,278,944	\$ 13,564,699	\$ 12,358,566	\$ 11,356,600
Accounting change	\$ 503,471	\$ 273,792	\$ 335,504	\$ 299,244	\$ 309,400
Earnings	\$ 503,471	\$ 273,792	\$ 335,504	\$ 273,515	\$ 308,600
Earnings per share from continuing operations before cumulative effect of accounting change:					
Basic	\$ 1.79	\$ 0.88	\$ 1.08	\$ 0.97	\$ 1.00
Diluted	1.75	0.87	1.06	0.95	0.99
Earnings per share:					
Basic	\$ 1.79	\$ 0.88	\$ 1.08	\$ 0.88	\$ 1.00
Diluted	1.75	0.87	1.06	0.87	0.99
Statistical Data:					
Retail facilities open at end of period:					
United States and Canada:					
Service supply stores	1,158	1,047	969	900	800
Distribution centers	20	20	22	22	20
Centers		3	13	13	13
International ⁽⁶⁾ :					
Service supply stores	125	70	78	64	50
Distribution centers	32	25	25	25	25
Centers	30	31	31	31	31
Total square footage - North American Retail Division	28,520,269	26,261,318	24,791,255	23,620,343	23,203,000
Percentage of sales by segment:					
North American Retail Division	45.2%	45.6%	43.8%	45.7%	51.0%
North American Business Solutions Division	30.5%	30.1%	29.8%	32.1%	34.0%
International Division	24.3%	24.3%	26.4%	22.2%	14.0%
Balance Sheet Data:					
Total assets	\$ 6,557,438	\$ 6,098,525	\$ 6,794,338	\$ 6,194,679	\$ 4,765,800
Long-term debt, excluding current maturities	570,752	569,098	583,680	829,302	411,900

(1) Certain amounts restated. See Note B in the Notes to

Consolidated
Financial
Statements.

- (2) Includes 53 weeks in accordance with our 52 - 53 week reporting convention.
- (3) Statements of Earnings Data for fiscal years 2003 and 2002, and Balance Sheet Data for 2003, have been restated to reflect adjustments for lease accounting.
- (4) Reflects the acquisition of Guilbert in June. Also, net earnings and net earnings per share data reflect cumulative effect of adopting a new accounting pronouncement.
- (5) As applicable, amounts have been adjusted to reflect the Australian business as discontinued operations.
- (6) Facilities of wholly-owned or majority-owned

entities operated
by our
International
Division.

Table of Contents**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.****RESULTS OF OPERATIONS****GENERAL**

Our fiscal year results are based on a 52- or 53-week retail calendar ending on the last Saturday in December. Fiscal years 2006 and 2004 include 52 weeks; fiscal year 2005 is based on 53 weeks, with a 14-week fourth quarter. Our comparable store sales (or comp sales) relate to stores that have been open for at least one year. For 2005, this comparison has been adjusted to a 52-week basis.

Results of Audit Committee Independent Review and Restatement of Financial Statements

On October 29, 2007, the company announced that its Audit Committee initiated an independent review principally focused on the accounting for certain vendor program funds. The Audit Committee, with the assistance of independent legal counsel and forensic accountants, assessed the timing of recognition of certain vendor program arrangements. The review, which arose from a whistleblower complaint, revealed that during the period beginning in the third quarter of 2006 through the second quarter of 2007 funds due or received from vendors previously recognized in the current quarter should have been deferred into later periods.

The investigation revealed errors in timing of vendor program recognition and included evidence that some individuals within the company's merchandising organization failed to provide Office Depot's accounting staff with complete or accurate documentation of future purchase or performance conditions in certain vendor programs that would have otherwise required recognition of the related vendor funds to be deferred into future periods in accordance with the company's established practices.

Based on both the qualitative and quantitative factors, the company concluded that the errors were material and the Board of Directors approved a restatement of the periods from the third quarter of 2006 through the second quarter of 2007. In addition to this Amendment No. 1 on Form 10-K/A, the company will file concurrently Forms 10-Q/A for the first and second quarters of 2007.

The impact of these errors is to reduce previously reported gross profit, operating profit, net earnings and earnings per share in prior quarters and recognize related amounts into future periods. The company's amended reports reflect a reduction in diluted earnings per share of \$0.02 in the quarter ended September 30, 2006, \$0.03 in the quarter ended December 30, 2006, \$0.01 in the quarter ended March 31, 2007, and \$0.02 in the quarter ended June 30, 2007 as compared to amounts previously reported. Because of rounding and changes in share count, the diluted EPS impact over the period aggregates to \$0.04 for fiscal year 2006 and a total of \$0.07 per share over the period from the third quarter of 2006 through the second quarter of 2007. The future impact of the deferrals related to one period were considered in determining net deferrals in subsequent periods. The net deferral becomes a positive impact beginning in the later part of 2007 and extending through the years from 2008 through 2010. The financial restatements have resulted in reductions of previously reported company gross profit of approximately \$7 million in the quarter ended September 30, 2006, \$14 million in the quarter ended December 30, 2006 (an aggregate of \$20 million for fiscal year 2006), \$3 million in the quarter ended March 31, 2007, and \$6 million in the quarter ended June 30, 2007.

Approximately \$4 million of vendor program funds which were identified during the investigation which would otherwise have been recognized in the quarter ended September 29, 2007 will also be deferred as a result of this review. The aggregate deferrals will be recognized in decreasing amounts through 2010, with approximately \$12 million expected to be recognized in the quarter ending December 29, 2007, \$15 million in fiscal year 2008 and the remainder in the future periods.

These restatements relate to non-cash items and the reduction in net earnings has been offset in the consolidated statement of cash flows by a change in working capital and other items such that net cash provided by operating activities has not changed for the periods restated. The impact to the balance sheet has been to reduce inventories by the amounts deferred and to increase short-term deferred tax assets for the tax impacts of the change in pre-tax earnings.

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The following Management's Discussion and Analysis gives effect to the restatement.

OVERVIEW

Fiscal year 2006 has been a year of growth across the company. We have exceeded \$15 billion in sales for the first time by increasing sales levels in each of our operating Divisions, even when compared to a 53-week year in 2005. On a comparable 52-week basis, these sales increases are even greater. Also, full year Division gross profit and Division operating profit increased in North America and International. These results were realized at the same time as opening 115 new stores and remodeling another 176 stores in North America, investing in our contract sales force in North America and Europe and expanding our geographic presence with acquisitions in North America, Europe and Asia. Major contributors to our 2006 results are summarized below and reviewed further in the segment discussions.

Excluding the 53rd week from 2005, total company sales increased 6% compared to 2005. North American Retail Division comp store sales grew 2%.

During 2006, we refined our measure of Division operating profit to include general and administrative expenses directly or closely attributable to each reportable segment and to exclude charges related to programs initially identified in 2005 following a company-wide review of operations, processes and commitments (the Charges). These Charges will continue to be recognized in future periods as the plans are implemented and the related accounting criteria are met. Also, we continue to explore ways to enhance our financial reporting and may refine presentation or allocations in future periods.

Diluted earnings per share for 2006 (as restated), 2005 and 2004 were \$1.75, \$0.87 and \$1.06, respectively. The Charges had a \$0.15 per share impact in 2006 and a \$0.59 per share impact in 2005. The positive impact of the 53rd week on 2005 net earnings was approximately \$0.05 per diluted share.

In the fourth quarter of 2006, we recognized a gain on building sale after debt termination of approximately \$0.04 per share. We also recorded a charge to settle litigation of approximately (\$0.04) per share.

After considering the impact of the Charges, building gain and legal settlement, our operating expenses as a percent of sales declined as a result of various cost control efforts, operational improvements and improved leverage from higher sales.

During 2006, we acquired all or a majority interest in certain entities headquartered in South Korea, North America, the Czech Republic and China, and increased our previous investment to a majority position in an entity in Israel. Results of those entities have been consolidated in our financial statements since the dates of acquisition.

Cash flow from operating activities was \$827 million in 2006 and totaled \$2.1 billion over the past three year period.

Under plans approved by our board of directors, we acquired 26.4 million shares of our common stock during the year.

OPERATING RESULTS

Our overall sales increased 5% in both 2006 and 2005. However, 2005 was a 53-week year based on our fiscal calendar. On a comparable 52-week basis, fiscal 2006 sales increased 6%, compared to an increase of 4% in 2005. Each of our Divisions reported higher sales in 2006 on both a comparable 52-week basis and when compared to the 53-week period in 2005. The sales increase in 2006 reflects positive organic growth, the impact of acquisitions during the year and positive foreign currency impacts in our International Division. The 2005 increase reflects higher sales in our North American operations, partially offset by a decline in the International Division from reduced local currency sales.

The increase in gross profit as a percentage of sales in 2006 reflects the net impact of higher private brand sales and better category management, partially offset by competitive pressures in certain areas and some change in product sales mix. Cost of goods sold in 2006 and 2005 include the negative impact of \$1 million and \$20 million, respectively, of inventory-related Charges.

Total store and warehouse operating and selling expenses as a percentage of sales decreased in 2006 and increased in 2005. The 2006 and 2005 totals include Charges of approximately \$37 million and \$109 million, respectively. Expenses that were similar in nature to these Charges, but not part of the Charges programs totaled \$39 million in 2004. After considering those charges, store and warehouse operating and selling expenses as a percent of sales decreased in both 2006 and 2005. The 2006 decrease reflects operational efficiencies and sales leverage, partially

offset by higher costs from accelerated store remodel and new store opening

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activities, as well as initial costs for an expanded sales force and the integration of several acquisitions during the year. The reductions in 2005 also reflect the success we realized in improving our advertising cost effectiveness throughout 2005, as well as leverage from the 53rd week of sales.

Effective with the beginning of the third quarter of 2005, we adopted Statement of Financial Accounting Standards No. 123 (R) (FAS 123R) using the modified prospective method. Under this method, the portions of previously granted share-based payments that were unvested at the date of adoption, as well as the fair value of awards granted after adoption, are included in operating expenses over the appropriate service period.

Discussion of other income and expense items, including the Charges and changes in interest and taxes follows our review of the operating segments. As noted above, during 2006, we modified our presentation of Division operating profit by including general and administrative expenses considered directly or closely attributable to each reportable segment and excluding the Charges recognized during the period to conform to the internal presentation used to manage the business.

NORTH AMERICAN RETAIL DIVISION

<i>(Dollars in millions)</i>	2006	2005	2004
	(Restated)		
Sales	\$6,789.4	\$6,510.2	\$5,940.7
% change	4%	10%	5%
Division operating profit	\$ 454.3	\$ 393.6	\$ 291.3
% of sales	6.7%	6.0%	4.9%

Total sales in the North American Retail Division increased 4% in 2006 and 10% 2005 compared to the prior periods. However, 2006 sales increased 6% over the prior year after consideration of the impact of the additional week in 2005. Comp store sales in 2006 from the 1,036 stores that were open for more than one year increased 2%. Comp store sales in 2005 from the 945 stores that were open for at least one year increased 3%. The growth in total sales reflects our new store openings, as well as improved selling efforts and effective merchandising and marketing programs. During 2006 and 2005, we increased our private brand offerings, continued improving the effectiveness of our inserts and advertising campaigns and maintained our official office supply partnership with NASCAR®. Also during 2006, we transformed our previous Advantage loyalty program into our WorkLife™ Rewards program, which has continued to promote long-term customer relationships.

Overall gross margins increased in 2006 and 2005 compared to the prior year. We have expanded our selection of private brands which has had a positive impact on gross margins, and we expect to continue developing additional product offerings. We continue to increase our mix of technology sales, which are lower margin products, but have benefited from category management and higher attachment rates. Furniture sales were lower, we believe reflecting the impact of softness in the housing market on our home office furniture sales. Our operating expenses as a percent of sales were lower in 2006 compared to 2005, reflecting lower store operating costs, somewhat offset by higher advertising costs and our store remodeling program. The store expansion and remodel program has impacted our operating expenses by additional pre-opening expenses related to new stores, as well as accelerating depreciation for stores being remodeled and incurring non-capitalizable remodeling costs. We exclude the brief remodel period from our comp sales calculation to account partially for some of the disruption. The new store and store remodel activity lowered the Division operating profit percentage by approximately 50 basis points in 2006 compared to 2005.

We opened 115 new stores during 2006 and 100 stores during 2005, all using our improved M2 store design. At the end of 2006, we operated 1,158 retail stores in the U.S. and Canada. We anticipate opening approximately 150 stores in 2007 and 200 additional stores in 2008. We also remodeled 176 stores during 2006 and 13 stores in 2005. We have a goal of remodeling substantially all remaining stores over the next two years.

NORTH AMERICAN BUSINESS SOLUTIONS DIVISION

<i>(Dollars in millions)</i>	2006	2005	2004
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	(Restated)		
Sales	\$4,576.8	\$4,300.8	\$4,045.5
% change	6%	6%	2%
Division operating profit	\$ 367.0	\$ 350.8	\$ 276.2
% of sales	8.0%	8.2%	6.8%
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Sales in our North American Business Solutions Division increased 6% in both 2006 and 2005. However, sales increased 9% over the prior year after consideration of the impact of the additional week in 2005. The sales increase in 2006 reflects organic growth in our contract sales channel, as well as the impact of an acquisition completed in mid-May 2006. Sales in our contract channel also increased in 2005 compared to 2004 as we added sales force and made changes in account management. The increase in 2005 reflects broad-based revenue growth. During 2005, we began offering a combined catalog to the previously separate Office Depot and Viking catalog customers and completed that integration in 2006. As expected, direct channel sales were lower in 2006 following the conversion as we deliberately reduced some unprofitable business, and we anticipate lower comparisons until about mid-year 2007 when the impact of this combined offering is reflected in both periods.

Gross margin in this Division declined in 2006 compared to 2005, reflecting paper cost increases and a higher mix of contract business, partially offset by additional private brand offerings. Operating expenses increased from our investment in additional sales personnel, as well as short-term costs related to the integration of a contract business acquired during the year and the outsourcing of telephone account management and a new delivery initiative. We expect the impact of these costs to moderate during the first half of 2007 as these activities mature and costs for incremental activities are captured in both periods. During 2006 and 2005, our lower delivery expenses were partially offset by higher fuel costs. During 2004, we reorganized our sales force and decided to consolidate our call centers and outsource certain activities; that process was completed in the third quarter of 2005 and had a positive impact on subsequent operating expenses.

INTERNATIONAL DIVISION

<i>(Dollars in millions)</i>	2006	2005	2004
Sales	\$3,644.6	\$3,470.9	\$3,580.8
% change	5%	(3)%	30%
Division operating profit	\$ 249.2	\$ 207.5	\$ 278.0
% of sales	6.8%	6.0%	7.8%

Sales in our International Division increased 5% in 2006 and declined 3% in 2005. However, local currency sales increased 7% over the prior year after consideration of the impact of the additional week in 2005. The increase in sales in 2006 reflects improved performance in all channels and the impact of acquisitions. During 2006, we acquired all or a majority interest in entities headquartered in South Korea, the Czech Republic and China, and increased our previous investment to a majority position in an entity in Israel. Results of those entities have been consolidated in our financial statements since the dates of acquisition. The sales decline in 2005 compared to 2004 reflects competitive pressures in both the contract and catalog channels and challenging economic conditions in many Western European countries. Also in 2005, we closed the contract business in one country as well as 14 retail stores, contributing to the sales decline.

Gross profit as a percentage of sales decreased slightly in 2006, but stabilized in the later half of the year, after a more significant decline in 2005. The 2006 decrease reflects the addition of lower margin business, as well as an increase in the relative proportion of contract sales, partially offset by increased private brand sales. The 2005 decrease reflects competitive pressures in important product categories across channels and the impact of increased contract sales.

Operating expenses as a percentage of sales decreased in 2006 compared to 2005 reflecting operational efficiencies from streamlining activities initiated in 2005 and continuing in 2006. During 2006, we have increased the size of our contract sales force across Europe and increased the use of telephone account managers to drive account penetration. Operating expenses as a percentage of sales increased slightly in 2005 compared to 2004, primarily reflecting reduced leverage from lower sales.

For U.S. reporting, the International Division's sales are translated into U.S. dollars at average exchange rates experienced during the year. The Division's sales were positively impacted by foreign currency exchange rates in 2006 by \$23.0 million, and were negatively impacted in 2005 by \$2.5 million. Division operating profit was also positively impacted from changes in foreign exchange rates by \$2.0 million in 2006, and negatively by \$1.6 million in 2005.

Internally, we analyze our international operations in terms of local currency performance to allow focus on operating trends and results.

Table of Contents**CORPORATE AND OTHER****Asset Impairments, Exit Costs and Other Charges**

During the third quarter of 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. At the end of 2005, we estimated the total charges to be incurred over a multi-year period would be approximately \$406 million. We have since revised that estimate to be approximately \$454 million. Of this amount, \$282 million was recognized in 2005 and \$63 million was recognized in 2006. We estimate that \$72 million and \$37 million will be recognized in 2007 and 2008, respectively. The expenses associated with these future activities will be recognized as the individual plans are implemented and the related accounting recognition criteria are met. As with any estimate, the amounts may change when expenses are incurred.

These business reviews were performed at a Division level and initially we reported the charges associated with these activities as a component in determining Division operating profit. The financial information used by our management to assess performance of the Divisions for the purpose of resource allocation now excludes the Charges. We believe this measure is an appropriate and useful indicator of the effectiveness of current management activities. Accordingly, we have revised our measure of Division operating profit for external reporting purposes and now report on the Charges at a corporate level. Prior period Division operating profit has been recast to conform to the current presentation.

A summary of the Charges and the line item presentation of these amounts in our accompanying Consolidated Statements of Earnings is as follows.

<i>(Dollars in millions, except share amounts)</i>	2006	2005
	Amounts	Amounts
Cost of goods sold and occupancy costs	\$ 1	\$ 20
Store and warehouse operating and selling expenses	37	109
Asset impairments	7	133
General and administrative expenses	18	20
Total pre-tax Charges	63	282
Income tax effect	(21)	(97)
After-tax impact	\$ 42	\$ 185
Per share impact	\$0.15	\$0.59

Of the \$282 million pre-tax charge recognized in 2005, approximately \$133 million related to asset impairments, approximately \$72 million of exit costs and approximately \$77 million of costs associated with termination agreements relating to contracts and surplus leases, accelerated amortization of software and depreciation of assets based on changes in estimated useful lives and the write off of certain property and inventory no longer used or useful based on this business review.

The asset impairment charge of \$133 million included \$83 million related to certain former Kids R Us (KRU) retail store locations acquired in 2004 from Toys R Us, Inc. The performance of many of these locations did not meet initial projections to recover the initial asset base. We also recognized a \$41 million goodwill and other intangible asset charge related to our Tech Depot subsidiary. A change in market conditions for technology products and a shift in that subsidiary's emphasis resulted in lowering our projected cash flows and goodwill was written down to estimated fair value. Also, as part of this business review and to streamline operations, we decided to migrate customers from the Guilbert trade name to Office Depot. The existing trade name intangible asset was tested for impairment and written down by approximately \$9 million to the amount that we estimated to be recoverable over the one-year migration plan.

The KRU, Tech Depot and trade name impairment charges are combined in the Consolidated Statement of Earnings on the line item titled Asset impairments. Following the fourth quarter review of goodwill and intangible assets in

2004, we recognized a goodwill impairment charge of approximately \$12 million related to our investment in Japan. Because of its nature, that charge has been presented on this same line for comparative purposes, but was not part of the Charges programs.

In addition to these significant asset impairment charges, we also recognized significant charges related to exit and other activities. The total exit and other charges recorded in 2005 and anticipated for future periods will be discussed below, as well as where the Charges appear in the Consolidated Statement of Earnings.

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We decided to close 25 retail stores (16 in North America and nine internationally), three warehouses (two in North America and one internationally) and consolidate certain international call center and contract operations. Accordingly, we recognized approximately \$72 million of charges for future lease obligations, severance-related costs, accelerated depreciation, asset write offs and inventory clearance and disposal. Of this total, approximately \$8 million of inventory-related costs were recognized in cost of goods sold, approximately \$61 million in store and warehouse operating and selling expenses and approximately \$3 million in general and administrative expenses. In addition to these exit costs, we recognized approximately \$77 million of other charges. We terminated certain contractual agreements and adjusted surplus lease property accruals, wrote down and accelerated depreciation on assets based on a decrease in their expected use and accelerated inventory clearance activity in preparation of implementing a new inventory management system. Of this total, approximately \$12 million was presented as a charge in cost of goods sold, approximately \$48 million in store and warehouse operating and selling expenses and approximately \$17 million in general and administrative expenses. During 2006, an additional \$63 million associated with these projects was recognized as the previously-identified plans were implemented and the related accounting recognition criteria were met. These projects primary related to consolidating and streamlining activities and resulted in charges for severance-related expenses, accelerated depreciation and amortization and other expenses. Of this total, approximately \$1 million was recognized in cost of goods sold, approximately \$37 million in store and warehouse operating and selling expenses, \$7 million in asset impairments related to additional KRU properties and \$18 million in general and administrative expenses. Some of these activities, such as planned facility closings, will extend into 2007 and 2008. The costs associated with these activities will be recognized in future periods as incurred, or in the case of asset utilization, over the period of remaining estimated useful life. A summary of past and estimated future charges is presented below.

<i>(Dollars in millions)</i>	2005 Actual	2006 Actual	Estimated		Total Charges
			2007	2008	
Asset impairments	\$ 133	\$ 7	\$	\$	\$ 140
Cost of goods sold	20	1			21
Asset write-offs and accelerated depreciation	54	21	24	4	103
Lease obligations/Contract terminations	61	9	2	10	82
One-time termination benefits	11	22	40	16	89
Other associated costs	3	3	6	7	19
Total pre-tax charges	\$282	\$63	\$72	\$37	\$454

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 our foreign operations. Of the total Charges, approximately \$184 million either has or is expected to require cash settlement, including longer-term lease obligations that will require cash over multi-year lease terms; approximately \$270 million of Charges are non-cash items.

General and Administrative Expenses

<i>(Dollars in millions)</i>	2006	2005	2004
General and administrative expenses	\$651.7	\$666.6	\$665.8
% of sales	4.3%	4.7%	4.9%

General and administrative (G&A) expenses include Charges of approximately \$18 million in 2006 and \$20 million in 2005. Additionally in 2006, we recognized a charge of approximately \$16 million as an agreement in principle to settle wage and hour litigation in California. G&A expenses in 2004 include approximately \$22 million of executive

and staff severance, dispute resolutions, loss on disposal of property and lease termination costs associated with property used in G&A functions. After considering these charges, the remaining change in total G&A expenses in 2006 compared to 2005 reflects the positive impacts of various cost control measures and consolidating functions. G&A expenses in 2005 compared to 2004 benefited from lower professional fees and the effect of cost control measures, partially offset by increases from the adoption of FAS 123R and acceleration of certain variable pay and restricted stock awards earned in 2005.

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During 2006, we decided to allocate to our Divisions those G&A expenses that are directly or closely related to their operations. Those amounts are now included in our determination of each Division's operating profit. We have recast prior periods for meaningful comparisons. Other companies may charge more or less G&A expenses and other costs to their segments, and our results therefore may not be comparable to similarly titled measures used by other entities.

Gain on Sale of Building

In December 2006, we sold our corporate campus and entered into a leaseback agreement until construction of our new facility is complete. The sale resulted in a gain of approximately \$21 million recognized in 2006 and \$15 million deferred over the leaseback period. We have also entered into a longer-term lease on a new facility nearby that is expected to be available for occupancy at or about the end of 2008.

Other Income and Expense

<i>(Dollars in millions)</i>	2006	2005	2004
Interest income	\$ 9.8	\$ 22.2	\$ 20.0
Interest expense	(40.8)	(32.4)	(61.1)
Loss on extinguishment of debt	(5.7)		(45.4)
Miscellaneous income, net	30.6	23.6	17.7

Interest income decreased in 2006 as a result of lower average cash balances, partially offset by higher interest rates.

The change in 2005 compared to 2004 reflects modestly higher interest rates.

The increase in interest expense in 2006 compared to 2005 primarily results from the 2005 reduction of interest requirements following the favorable settlement of various tax claims. The 2005 comparison to 2004 also reflects the impact of our redemption in December 2004 of the entire issue of the \$250 million senior subordinated notes. The loss on extinguishment of debt in 2006 represents the \$5.7 million make whole payment related to settlement of the mortgage on our corporate campus that was sold during the year. The net loss on extinguishment of debt of \$45.4 million for 2004 included the make whole payment, write off of deferred issuance costs, and recognition of a previously deferred gain related to an interest rate swap.

Our net miscellaneous income consists of our earnings of joint venture investments, royalty and franchise income, and realized gains and impairments of other investments, if any. Our investments are non-controlling interests in Office Depot stores outside North America. Earnings from these investments increased \$3.7 million in 2006 and \$7.2 million in 2005. We increased our ownership interest in Office Depot Israel during 2006 and have consolidated its results since the date of additional investment. We continue to look for ways to expand our presence overseas and may enter into additional ventures or increase our investment in existing positions which could result in additional entities being consolidated in future periods.

Income Taxes

<i>(Dollars in millions)</i>	2006	2005	2004
	(Restated)		
Income Taxes	\$ 203.6	\$ 87.7	\$ 125.7
Effective income tax rate*	29%	24%	27%

* Income Taxes as a percentage of earnings from continuing operations before income taxes.

The effective income tax rate increased in 2006, reflecting a greater impact in the prior year from closing certain worldwide tax audits and adjusted provisions for uncertain tax positions. Fiscal year 2006 also benefited from lower

net international tax expense and is more in line with our anticipated base effective tax rate of approximately 30% for 2007. During 2005, we also adjusted certain valuation allowances based on our current assessment of realization of the related deferred tax assets. This decrease was partially offset by additional tax expense from completing our plans to repatriate additional foreign earnings.

During 2004, we recognized tax expense related to our preliminary assessment of foreign earnings to be repatriated in 2005 under the provisions of the American Jobs Creation Act. We also recognized tax benefits from reducing existing valuation allowances on deferred tax assets, from audit settlements and from the release of previously recorded accruals for uncertain tax positions based on changes in the facts and circumstances.

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The effective tax rate in future periods can be affected by variability in our mix of income, the tax rates in various jurisdictions, changes in the rules related to accounting for income taxes, outcomes from tax audits that regularly are in process and our assessment of the need of accruals for uncertain tax positions, and therefore may be higher or lower than it has been over the past three years.

The Financial Accounting Standards Board has approved new rules applying to the accounting for uncertain tax positions. These rules become effective in the first quarter of 2007. We do not anticipate that adoption of these rules will have a material impact on our retained earnings at the date of adoption but could introduce additional volatility into our effective income tax rate in future periods.

LIQUIDITY AND CAPITAL RESOURCES**Liquidity**

We have consistently satisfied operating liquidity needs and planned capital expenditure programs through our normal conversion of sales to cash. Over the three years ended in 2006, we generated approximately \$2.1 billion of cash flows from operating activities. At December 30, 2006, we had approximately \$174 million in cash and equivalents and another \$589 million available under our revolving credit facility. We anticipate opening 150 new stores in 2007 and 200 additional stores in 2008. We expect to remodel substantially all remaining stores over the next two years and to continue to make supply chain network improvements. Also, we will continue to look outside the company for additional growth opportunities, as well as consider additional share repurchases.

We continually review our financing options. Although we currently anticipate that we will fund our 2007 operations, expansion and other activities through cash on hand, funds generated from operations, property and equipment leases and funds available under our credit facilities, we may consider alternative financing as appropriate for market conditions.

We hold cash throughout our service areas, but we principally manage our cash through regional headquarters in North America and Europe. We may move cash between those regions from time to time through short-term transactions, including \$144 million that we transferred from Europe to North America and paid down our revolving line of credit at the end of the fourth quarter of 2006. We transferred these amounts at the end of the quarter which reduced the amount outstanding under the revolving credit facility reported at the end of the financial reporting period. During the first quarter of 2007, we borrowed a like amount under our revolving credit facility to repay the amount transferred from Europe. Similar transfers are likely at future quarterly periods, pending completion of a non-taxable distribution to the U.S. anticipated in the fourth quarter of 2007. Other distributions, including distributions of foreign earnings or changes in long-term arrangements could result in significant additional U. S. tax payments and income tax expense. There are no current plans to change our expectation of foreign earnings reinvestment or the long-term nature of our intercompany arrangements.

Our existing credit agreement is a \$750 million unsecured multi-currency revolving credit facility, which includes up to \$350 million available for standby and trade letters of credit. This facility is available through April 2010. Upon mutual agreement, the maximum borrowing may be increased to \$1 billion. The agreement provides borrowings up to the total amount in U.S. dollars, British pounds, euro, or yen. We may elect interest periods of one, two, three, six, nine or twelve months. Interest is based on the London Interbank Offering Rate (LIBOR), or a yen-based-LIBOR as appropriate, plus a spread determined at the time of usage. Based on our current credit ratings, borrowings include a spread of 0.475%. The effective interest rate on yen borrowings at the end of 2006 was 1.1%. At December 30, 2006, we had approximately \$589.0 million of available credit under our revolving credit facility that includes coverage of \$96.8 million of outstanding letters of credit. We had an additional \$48.5 million of letters of credit outstanding under separate agreements.

We are in compliance with all restrictive covenants included in our debt agreements.

We have never paid a cash dividend on our common stock. While our board of directors regularly assesses our dividend policy, there are no current plans to declare a dividend.

Cash provided by (used in) our operating, investing and financing activities is summarized as follows:

<i>(Dollars in millions)</i>	2006	2005	2004
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Operating activities	\$ 827.1	\$ 635.9	\$ 645.9
Investing activities	(485.2)	(52.2)	(426.6)
Financing activities	(889.1)	(630.7)	(256.5)

Operating Activities

The change in cash flow from operating activities during 2006 reflects increased contribution from the core business and positive impacts of working capital management. Throughout the year, we have worked to collect our cash more timely and to better align trade payables with inventory turnover. The timing of payments is subject to variability during the year depending on a variety of factors, including the flow of goods, credit terms, timing of promotions, vendor production planning, new product introductions and working capital management. The company manages the timing of accounts payable and has deferred payments to vendors near quarter-end which has the effect of reducing its working capital position. The effect of such vendor payment deferrals at quarter-end on our financial statements is to report a higher accounts payable balance and lower balance of outstanding borrowings on our revolving credit facility than would otherwise appear if the vendor payments had not been deferred. Such deferrals totaled approximately \$50 million at year end 2006, none at year end 2005 and \$200 million at year end 2004. For the company's accounting policy on cash management, see Note A of the Notes to Consolidated Financial Statements. Deferrals may increase or decrease in future periods as conditions warrant. The change in cash flows from operating activities during 2005 reflects increased business performance after considering non-cash elements of the Charges and non-cash equity compensation, offset by the reduction of trade payables and payment of taxes. Following our adoption of FAS 123R in the third quarter of 2005, the presentation of tax benefits received from the exercise of stock options in excess of the tax benefit on their estimated fair value has changed from a component of operating activities to a component of financing activities in the statement of cash flows. Operating cash flow in 2004 includes the impact of higher accounts receivable balances from increased fourth quarter sales activity, as well as an increase in receivables

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from vendors. The higher volume of purchases finalized at the end of the year, along with the increase in promotional activity contributed to the increase in receivables from our vendors.

Investing Activities

During 2006 and 2005, we invested \$343.4 million and \$260.8 million, respectively in capital expenditures. This activity includes the opening, relocating and remodeling of retail stores in North America, as well as warehouse, logistics and infrastructure improvements in the International Division and for corporate assets. The 2004 capital expenditures of \$391.2 million included \$90.6 million to acquire retail store locations in an asset purchase transaction. During 2006, we acquired all or a majority ownership position in entities in North America, the Czech Republic, South Korea, and China, as well as increased our ownership position in our previous investment in Israel. We may continue to expand our global presence with acquisitions or the development of existing business with the corresponding use of cash for investing activities. During 2004, we acquired retail stores in Hungary that had operated as Office Depot stores under a licensing agreement in that country.

Proceeds from the disposition of assets in 2006 includes approximately \$80 million in cash received from the sale of our corporate campus. Approximately \$22 million from the sale was used to satisfy an existing mortgage and is included as a use of cash in financing activities.

Management of our cash and short-term investment activity resulted in a net cash source of approximately \$160 million in 2005, compared to a net investment of approximately \$63 million in 2004.

Financing Activities

The Office Depot board of directors has authorized open market purchases of the company's common stock under repurchase plans that were in effect during the three years presented. Under the approved plans, we purchased 26.4 million shares in 2006 at a cost of \$970.6 million; 29.8 million shares in 2005 at a cost of \$815.2 million; and 4.0 million shares in 2004 at a cost of \$65.6 million. At the end of 2006, approximately \$200 million remained available for additional repurchases under the most recent board approved plan. We may continue to repurchase shares as we believe conditions warrant. Proceeds from issuance of common stock under our employee related plans were \$101.0 million in 2006, \$175.9 million in 2005 and \$70.6 million in 2004. Following the adoption of FAS 123R in the third quarter of 2005, cash from tax benefits on employee related plans that are in excess of amounts based on grant date fair value are presented as financing activities. Additionally, at the issuance of certain restricted stock awards, employees surrendered shares to the company equal to approximately \$12.8 million in exchange for our settlement of their taxes due on these shares.

In connection with the sale of our corporate campus in 2006, a portion of the proceeds was used to liquidate an existing mortgage on one of the facilities.

In December 2004, we redeemed the entire issue of our \$250 million senior subordinated notes, pursuant to the optional redemption provisions of the subordinated notes indenture. The payment of approximately \$302 million included the principal, accrued interest to the termination date, and contractual interest, discounted at the appropriate U.S. Treasury rate plus 50 basis points.

Contractual Obligations

The following table summarizes our contractual cash obligations at December 30, 2006, and the effect such obligations are expected to have on liquidity and cash flow in future periods:

Contractual Obligations	Total	Less than 1 year	1 3 years	4 5 years	After 5 years
Long-term debt obligations ⁽¹⁾	\$ 681.8	\$ 65.8	\$ 51.4	\$ 114.6	\$ 450.0
Capital lease obligations ⁽²⁾	456.3	16.0	39.9	52.6	347.8
Operating leases ⁽³⁾	4,394.1	490.5	848.3	690.9	2,364.4
Purchase obligations ⁽⁴⁾	148.4	99.0	48.9	0.5	
Other long-term liabilities ⁽⁵⁾					
Total contractual cash obligations	\$5,680.6	\$671.3	\$988.5	\$858.6	\$3,162.2

- (1) Long-term debt obligations include our \$400 million senior notes and borrowings under our revolving credit facility, excluding any related discount. Amounts include contractual interest payments (using the interest rate as of December 30, 2006 for the revolving credit facility). Amounts due under our revolving credit facility have been classified according to its scheduled maturity in April 2010; however, we may refinance this borrowing under a future credit facility.

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- (2) The present value of these obligations, are included on our Consolidated Balance Sheets. See Note F of the Notes to Consolidated Financial Statements for additional information about our capital lease obligations.

- (3) Our operating lease obligations are described in Note H of the Notes to Consolidated Financial Statements.

- (4) Purchase obligations include all commitments to purchase goods or services of either a fixed or minimum quantity that are enforceable and legally binding on us that meet any of the following criteria: (1) they are noncancelable, (2) we would incur a penalty if the agreement was cancelled, or (3) we must make specified

minimum payments even if we do not take delivery of the contracted products or services. If the obligation is noncancelable, the entire value of the contract is included in the table. If the obligation is cancelable, but we would incur a penalty if cancelled, the dollar amount of the penalty is included as a purchase obligation. If we can unilaterally terminate the agreement simply by providing a certain number of days notice or by paying a termination fee, we have included the amount of the termination fee or the amount that would be paid over the notice period. As of December 30, 2006, purchase obligations include television, radio and newspaper advertising, sports sponsorship commitments,

telephone services, and software licenses and service and maintenance contracts for information technology. Contracts that can be unilaterally terminated without a penalty have not been included.

- (5) Our Consolidated Balance Sheet as of December 30, 2006 includes \$403.3 million classified as Deferred income taxes and other long-term liabilities. This caption primarily consists of our net long-term deferred income taxes, the unfunded portion of our pension plans, deferred lease credits, and liabilities under our deferred compensation plans. These liabilities have been excluded from the above table as the timing and/or the amount of

any cash payment is uncertain. See Note G of the Notes to Consolidated Financial Statements for additional information regarding our deferred tax positions and Note I for a discussion of our employee benefit plans, including the pension plans and the deferred compensation plan.

In addition to the above, we have letters of credit totaling \$48.5 million outstanding at the end of the year, and we have recourse for private label credit card receivables transferred to a third party. We record a fair value estimate for losses on these receivables in our financial statements. The total outstanding amount transferred to a third party at the end of the year was approximately \$225.7 million.

We have no other off-balance sheet arrangements other than those disclosed in the Contractual Obligations table.

CRITICAL ACCOUNTING POLICIES

Our 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 can be found in Note A in the Notes to Consolidated Financial Statements. We have also identified certain accounting policies that we consider critical to understanding our business and our results of operations and we have provided below additional information on those policies.

Vendor arrangements Each year, we enter into purchase arrangements with many of our vendors that provide for those vendors to make payments to us if and when certain conditions are met. We generally refer to these arrangements as vendor programs, and they typically fall into two broad categories, with some underlying sub-categories. The largest category is volume-based rebates. Generally, our product costs per unit decline as higher volumes of purchases are reached. Many of our vendor agreements provide that we pay higher per unit costs prior to reaching a predetermined milestone, at which time the vendor rebates the per unit differential on past purchases, and also applies the lower cost to future purchases until the next milestone is reached. Current accounting rules provide that companies with a sound basis for estimating their full year purchases, and therefore the ultimate rebate level, can use that estimate to value inventory and cost of goods sold throughout the year. We believe our history of purchases with many vendors provides us with a sound basis for our estimates.

If the anticipated volume of purchases is not reached, however, or if we form the belief at any given point in the year that it is not likely to be reached, cost of goods sold and the remaining inventory balances are adjusted to reflect that change in our outlook. We review sales projections and related purchases against vendor program estimates at least quarterly and adjust these balances accordingly.

The second category of arrangements we have with our vendors is event-based programs. These arrangements can take many forms, including advertising support and specific promotional activities. These advertising arrangements generally are classified as a reduction of product costs, reducing costs of goods sold and inventory.

Event-based arrangements include special pricing offered by certain of our vendors for a limited time, payments for special placement or promotion of a product, reimbursement of costs incurred to launch a vendor's product, and various other special

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programs. These payments are classified as a reduction of costs of goods sold or inventory, as appropriate for the program. Additionally, we receive payments from vendors for certain of our activities that lower the vendor's cost to ship their product. Such receipts are recognized as a reduction of our cost of goods sold.

While vendor rebates are recognized throughout the year based on judgment and estimates, the final amounts due from vendors are generally known soon after year-end. Substantially all vendor program receivables outstanding at the end of the year are collected within the three months immediately following year-end. We believe that our historic collection rates of these receivables provide a sound basis for our estimates of anticipated vendor payments throughout the year.

Inventory valuation Our selling model is predicated on the breadth and availability of our product assortment, and our profitability is impacted by inventory turnover rates. We monitor inventory on hand by location, particularly as it relates to trailing and projected sales trends. When slow moving inventory is identified, or we decide to discontinue merchandise, we review for estimated recoverability and, if necessary, record a charge to reduce the carrying value to our assessment of the lower of cost or market. This assessment is based on the quantity of the merchandise, the rate of sale, and our assessment of market conditions. Additional cost adjustments and sales markdowns will be taken as considered appropriate until the product is sold or otherwise disposed. Estimates and judgments are required in determining what items to stock and at what level, and what items to discontinue and how to value them prior to sale.

Intangible asset testing - Absent any circumstances that warrant testing at another time, we test for goodwill and non-amortizing intangible asset impairment as part of our year-end closing process.

Our goodwill testing consists of comparing the estimated fair values of each of our reporting units to their carrying amounts, including recorded goodwill. We estimate the fair values of each of our reporting units by discounting their projected future cash flows. Developing these future cash flow projections requires us to make significant assumptions and estimates regarding the sales, gross margin and operating expenses of our reporting units, as well as economic conditions and the impact of planned business or operational strategies. Should future results or economic events cause a change in our projected cash flows, or should our operating plans or business model change, future determinations of fair value may not support the carrying amount of one or more of our reporting units, and the related goodwill would need to be written down to an amount considered recoverable. Any such write down would be included in the operating expenses. We recognized goodwill and intangible asset impairments in both 2005 and 2004. While we make reasoned estimates of future performance, actual results below these expectations, or changes in business direction can result in additional impairment charges in future periods.

Closed store reserves and asset impairments We regularly assess the performance of each retail store against historic patterns and projections of future profitability. These assessments are based on management's estimates for sales growth, gross margin attainments, and cash flow generation. If, as a result of these evaluations, management determines that a store will not achieve certain targets, we may decide to close the store. When a store is no longer used for operating purposes, we recognize a liability for the remaining costs related to the property, reduced by an estimate of any sublease income. The calculation of this liability requires us to make assumptions and to apply judgment regarding the remaining term of the lease (including vacancy period), anticipated sublease income, and costs associated with vacating the premises. With assistance from independent third parties to assess market conditions, we periodically review these judgments and estimates and adjust the liability accordingly. We adjusted the carrying value of some of these obligations as part of the Charges. Future fluctuations in the economy and the market demand for commercial properties could result in material changes in this liability. Costs associated with facility closures are included in store and warehouse operating expenses.

In addition to the decision about whether or not to close a store, store assets are regularly reviewed for recoverability of their carrying amounts. The recoverability assessment requires judgment and estimates of a store's future cash flows. New stores may require years to develop a customer base necessary to achieve expected cash flows and we typically do not test for impairment during this early stage. However, if in subsequent periods, the anticipated cash flows of a store cannot support the carrying amount of the store's assets, an impairment charge is recorded to operations as a component of store and warehouse operating and selling expenses. To the extent that management's estimates of future performance are not realized, future assessments could result in material impairment charges. As discussed above, the Charges recorded in 2006 and 2005 include significant impairment charges.

Income taxes Income tax accounting requires management to make estimates and apply judgments to events that will be recognized in one period under rules that apply to financial reporting and in a different period in the company's tax returns. In particular, judgment is required when estimating the value of future tax deductions, tax credits, and net operating loss carryforwards (NOLs), as represented by deferred tax assets. When we believe the recovery of all or a portion of a deferred tax asset is not likely, we establish a valuation allowance. Generally, changes in judgments that increase or decrease these valuation allowances impact current earnings. Decreases in valuation allowances associated with NOLs acquired in a business combination reduce goodwill.

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In addition to judgments associated with valuation accounts, our current tax provision can be affected by our mix of income and identification or resolution of uncertain tax positions. Because income from domestic and international sources may be taxed at different rates, the shift in mix during a year or over years can cause the effective tax rate to change. We base our rate during the year on our best estimate of an annual effective rate, and update those estimates quarterly.

We file our tax returns based on our best understanding of the appropriate tax rules and regulations. However, complexities in the rules and our operations, as well as positions taken publicly by the taxing authorities may lead us to conclude that accruals for uncertain tax positions are required. We generally maintain accruals for uncertain tax positions until examination of the tax year is completed by the taxing authority, available review periods expire, or additional facts and circumstances cause us to change our assessment of the appropriate accrual amount. The Financial Accounting Standards Board has issued new accounting rules relating to uncertain tax positions that will be applied beginning in the first quarter of 2007.

SIGNIFICANT TRENDS, DEVELOPMENTS AND UNCERTAINTIES

Over the years, we have seen continued development and growth of competitors in all segments of our business. In particular, mass merchandisers and warehouse clubs, as well as grocery and drugstore chains, have increased their assortment of home office merchandise, attracting additional back-to-school customers and year-round casual shoppers. Recently, warehouse clubs have added to their in-store assortment by adding catalogs and Websites from which a much broader assortment of products may be ordered. We also face competition from other office supply superstores that compete directly with us in numerous markets. This competition is likely to result in increased competitive pressures on pricing, product selection and services provided. Many of these retail competitors, including discounters, warehouse clubs, and drug stores and grocery chains, carry basic office supply products. Some of them also have begun to feature technology products. Many of them price certain of these offerings lower than we do, but they have not shown an indication of greatly expanding their somewhat limited product offerings at this time. This trend towards a proliferation of retailers offering a limited assortment of office products is a potentially serious trend in our industry.

We have also seen growth in competitors that offer office products over the internet, featuring special purchase incentives and one-time deals (such as close-outs). Through our own successful internet and business-to-business web sites, we believe that we have positioned ourselves competitively in the e-commerce arena.

Another trend in our industry has been consolidation, as competitors in office supply stores and the copy/print channel have been acquired and consolidated into larger, well-capitalized corporations. This trend towards consolidation, coupled with acquisitions by financially strong organizations, is potentially a significant trend in our industry.

We regularly consider these and other competitive factors when we establish both offensive and defensive aspects of our overall business strategy and operating plans.

MARKET SENSITIVE RISKS AND POSITIONS

We have market risk exposure related to interest rates and foreign currency exchange rates. Market risk is measured as the potential negative impact on earnings, cash flows or fair values resulting from a hypothetical change in interest rates or foreign currency exchange rates over the next year. We manage the exposure to market risks at the corporate level. The portfolio of interest-sensitive assets and liabilities is monitored and adjusted to provide liquidity necessary to satisfy anticipated short-term needs. Our risk management policies allow the use of specified financial instruments for hedging purposes only; speculation on interest rates or foreign currency rates is not permitted.

Interest Rate Risk

We are exposed to the impact of interest rate changes on cash equivalents and debt obligations. The impact on cash and short-term investments held at the end of 2006 from a hypothetical 10% decrease in interest rates would be a decrease in interest income of less than \$1 million.

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Market risk associated with our debt portfolio is summarized below:

	2006			2005		
<i>(Dollars in thousands)</i>	Carrying Value	Fair Value	Risk Sensitivity	Carrying Value	Fair Value	Risk Sensitivity
\$400 million senior notes	\$400,489	\$410,360	\$11,200	\$400,595	\$417,405	\$12,725
Revolving Credit Facility	\$ 64,361	\$ 64,361	\$ 321	\$ 64,996	\$ 64,996	\$ 325

The risk sensitivity of fixed rate debt reflects the estimated increase in fair value from a 50 basis point decrease in interest rates, calculated on a discounted cash flow basis. The sensitivity of variable rate debt reflects the possible increase in interest expense during the next period from a 50 basis point change in interest rates prevailing at year-end.

Foreign Exchange Rate Risk

We conduct business in various countries outside the United States where the functional currency of the country is not the U.S. dollar. Our expansion in Europe in recent years increased our operations in countries with euro and British pound functional currencies. We continue to assess our exposure to foreign currency fluctuation against the U.S. dollar. As of December 30, 2006, a 10% change in the applicable foreign exchange rates would result in an increase or decrease in our operating profit of approximately \$16 million.

Although operations generally are conducted in the relevant local currency, we also are subject to foreign exchange transaction exposure when our subsidiaries transact business in a currency other than their own functional currency. This exposure arises primarily from a limited amount of inventory purchases in a foreign currency. The notional amount of foreign exchange forward contracts to hedge certain inventory exposures were \$92 million at their highest point during 2006. Also, from time-to-time we enter into foreign exchange forward transaction to protect against possible changes in exchange rates related to scheduled or anticipated cash movements among our operating entities. Generally, we evaluate the performance of our international businesses by focusing on the local currency results of the business, and not with regard to the translation into U.S. dollars, as the latter is impacted by external events.

INFLATION AND SEASONALITY

Although we cannot determine the precise effects of inflation on our business, we do not believe inflation has had a material impact on our sales or the results of our operations. We consider our business to be only somewhat seasonal, with sales in our North American Retail Division slightly lower during the second quarter. Certain working capital components may build and recede during the year reflecting established selling cycles, but we do not consider the company to be highly-seasonal.

NEW ACCOUNTING STANDARDS

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. While our analysis of the impact this Interpretation is not yet complete, we do not anticipate it will have a material impact on our retained earnings at the time of adoption.

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.

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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. At December 30, 2006, we have reported approximately \$6 million of deferred pension losses in accumulated other comprehensive income as a result of this new pronouncement. We do not expect the remaining elements of this Statement to have a material impact on our financial condition, results of operations, cash flows when adopted

FORWARD-LOOKING STATEMENTS

The Private Securities Litigation Reform Act of 1995 (the Act) provides protection from liability in private lawsuits for forward-looking statements made by public companies under certain circumstances, provided that the public company discloses with specificity the risk factors that may impact its future results. We want to take advantage of the safe harbor provisions of the Act. This Annual Report contains both historical information and other information that you can use to infer future performance. Examples of historical information include our annual financial statements and the commentary on past performance contained in our MD&A. While we have specifically identified certain information as being forward-looking in the context of its presentation, we caution you that, with the exception of information that is historical, all the information contained in this Annual Report should be considered to be

forward-looking statements as referred to in the Act. Without limiting the generality of the preceding sentence, any time we use the words estimate, project, intend, expect, believe, anticipate, continue and similar expressions intend to clearly express that the information deals with possible future events and is forward-looking in nature.

Certain information in our MD&A is clearly forward-looking in nature, and without limiting the generality of the preceding cautionary statements, we specifically advise you to consider all of our MD&A in the light of the cautionary statements set forth herein.

Forward-looking information involves future risks and uncertainties. Much of the information in this report that looks towards future performance of our company is based on various factors and important assumptions about future events that may or may not actually come true. As a result, our operations and financial results in the future could differ materially and substantially from those we have discussed in the forward-looking statements in this Report.

Significant factors that could impact our future results are provided in Item 1A. Risk Factors included in our 2006 Annual Report on Form 10-K/A. Other risk factors are incorporated into the text of our MD&A, which should itself be considered a statement of future risks and uncertainties, as well as management's view of our businesses.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

See the information in the Market Sensitive Risks and Positions subsection of Management's Discussion and Analysis of Financial Condition and Results of Operation set forth in Item 7 hereof.

Item 8. Financial Statements and Supplementary Data.

See Item 15(a) in Part IV.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

None.

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Item 9A. Controls and Procedures.

Restatement

On October 29, 2007, Office Depot announced that its Audit Committee initiated an independent review principally focused on the accounting for certain vendor program funds. The Audit Committee, with the assistance of independent legal counsel and forensic accountants, assessed the timing of recognition of certain vendor program arrangements. The investigation revealed errors in timing of vendor program recognition and included evidence that some individuals within the company's merchandising organization failed to provide Office Depot's accounting staff with complete or accurate documentation of future purchase or performance conditions in certain vendor programs that would have otherwise required recognition of the related vendor funds to be deferred into future periods in accordance with the company's established practices.

As a result of the Audit Committee's review, on November 8, 2007, the Board of Directors of the company approved a restatement of the company's 2006 financial statements including corrections to amounts reported in the third and fourth quarters of 2006 and the interim financial statements for the first and second quarters of 2007, and the company is concurrently amending its Form 10-K for the fiscal year 2006 and its Forms 10-Q for the first and second quarters of 2007.

In accordance with Section 404 of the Sarbanes-Oxley Act of 2002, our management assessed the effectiveness of our internal control over financial reporting. Based on both quantitative and qualitative factors, management has concluded that the findings detected during the investigation of the accounting for certain vendor program funds has resulted in the identification of a material weakness in internal controls over financial reporting. Management is evaluating and implementing changes in internal control over financial reporting relating to the timing of the recognition of vendor program funds in order to address the identified areas of the material weakness.

Disclosure Controls and Procedures

The company's management re-evaluated, with the participation of its principal executive officer and principal financial officer, the effectiveness of its disclosure controls and procedures as of the end of the period covered by this report. Disclosure controls and procedures mean the company's controls and other procedures that are designed to ensure that information required to be disclosed by the company in the reports that the company files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be in this report is made known to its management, including its principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure. The company's management recognizes that any controls and procedures, no matter how well designed and operated, can only provide reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the possible controls and procedures.

Based upon the re-evaluation of the company's disclosure controls and procedures, as of the end of the period covered by this report, the company's principal executive officer and principal financial officer concluded that, as of such date, the company's disclosure controls and procedures were not effective at the reasonable assurance level, due to the fact that there was a material weakness in our internal control over financial reporting (which is a subset of disclosure controls and procedures) related to the timing of purchase commitments with vendors and the recognition of vendor program funds which resulted in the errors described in Note B to the consolidated financial statements. This material weakness resulted from deficiencies in the design of internal controls related to ensuring that complete and accurate documentation is provided to individuals responsible for the proper recognition of vendor program funds.

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Internal Control Over Financial Reporting

(a) Management's Report on Internal Control Over Financial Reporting (revised)

See Item 15(a)1 in Part IV.

(b) Attestation Report of the Independent Registered Public Accounting Firm (revised)

See Item 15(a)1 in Part IV.

(c) Changes in Internal Controls

The identification of the material weakness discussed above occurred during the quarter ended September 29, 2007 and is a change that materially affected the company's internal control over financial reporting. The material weakness identified is the result of an internal investigation, which arose from a whistleblower complaint. The preliminary results of this investigation were brought to the attention of the Audit Committee who engaged counsel and commenced an independent investigation of the matter. The investigation revealed that certain types of vendor arrangements were not recognized as a reduction to cost of goods sold and occupancy costs in the correct fiscal period. The company made no changes to its internal control over financial reporting for the quarter ended December 30, 2006. However, the material weakness discussed above was identified during 2007 and will result in future mitigation activities.

Item 9B. Other Information.

None.

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PART III

Item 10. Directors and Executive Officers of the Registrant.

Information concerning our executive officers is set forth in Item 1 of this Form 10-K/A under the caption Executive Officers of the Registrant.

Information with respect to our directors and the nomination process is incorporated herein by reference to information included in the Proxy Statement for our 2007 Annual Meeting of Shareholders.

Information regarding our audit committee and our audit committee financial experts is incorporated herein by reference to information included in the Proxy Statement for our 2007 Annual Meeting of Shareholders.

Information required by Item 405 of Regulation S-K is incorporated herein by reference to information included in the Proxy Statement for our 2007 Annual Meeting of Shareholders.

We have adopted a Code of Ethical Behavior in compliance with applicable rules of the Securities and Exchange Commission that applies to its principal executive officer, its principal financial officer, and its principal accounting officer or controller, or persons performing similar functions. A copy of the Code of Ethical Behavior is available free of charge on the Investor Relations section of our web site at www.officedepot.com. We intend to satisfy any disclosure requirement under Item 5.05 of Form 8-K regarding an amendment to, or waiver from, a provision of this Code of Ethical Behavior by posting such information on our web site at the address and location specified above.

Item 11. Executive Compensation.

Information with respect to executive compensation is incorporated herein by reference to information included in the Proxy Statement for our 2007 Annual Meeting of Shareholders.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

Information with respect to security ownership of certain beneficial owners and management is incorporated herein by reference to information included in the Proxy Statement for our 2007 Annual Meeting of Shareholders.

Table of Contents**Securities Authorized for Issuance Under Equity Compensation Plans**

The following table provides information regarding compensation plans under which Office Depot equity securities are authorized for issuance as of December 30, 2006:

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants, and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (c)
Equity compensation plans approved by security holders:			
Long-Term Equity Incentive Plan (including the Long-Term Incentive Stock Plan) ⁽¹⁾	12,384,083	\$ 20.14	10,543,292 ⁽²⁾
Employee Stock Purchase Plan (ESPP)	Not Applicable	Not Applicable	172,593
Retirement Savings Plans	Not Applicable	Not Applicable	Not Applicable
Equity compensation plans not approved by security holders:			
None		Not Applicable	
Total	12,384,083	\$ 20.14	10,715,885

(1) Outstanding options under the Long-Term Incentive Stock Plan are satisfied with available securities from the Long-Term Equity Incentive Plan.

(2) As of December 30, 2006, the number of securities

remaining
available for
future issuance
has been
reduced by
approximately
4.4 million
shares of
restricted stock.

For a description of the equity compensation plans above, see Note I Employee Benefit Plans included under the heading Notes to Consolidated Financial Statements.

Item 13. Certain Relationships and Related Transactions.

Information with respect to such contractual relationships is incorporated herein by reference to the information in the Proxy Statement for our 2007 Annual Meeting of Shareholders.

Item 14. Principal Accountant Fees and Services.

Information with respect to principal accounting fees and services and pre-approval policies are incorporated herein by reference to information included in the Proxy Statement for our 2007 Annual Meeting of Shareholders.

PART IV

Item 15. Exhibits and Financial Statement Schedules.

(a) The following documents are filed as a part of this report:

1. The financial statements listed in Index to Financial Statements.
2. The financial statement schedules listed in Index to Financial Statement Schedule.
3. The exhibits listed in the Index to Exhibits.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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 on this 20th day of November 2007.

OFFICE DEPOT, INC.

By /s/ STEVE ODLAND
Steve Odland
Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant in the capacities indicated on November 20, 2007.

Signature	Capacity
/s/ STEVE ODLAND Steve Odland	Chief Executive Officer (Principal Executive Officer) and Chairman, Board of Directors
/s/ PATRICIA McKAY Patricia McKay	Executive Vice President and Chief Financial Officer (Principal Financial Officer)
/s/ JENNIFER MOLINE Jennifer Moline	Senior Vice President and Controller (Principal Accounting Officer)
/s/ LEE A. AULT, III Lee A. Ault, III	Director
/s/ NEIL R. AUSTRIAN Neil R. Austrian	Director
/s/ DAVID W. BERNAUER David W. Bernauer	Director
/s/ ABELARDO E. BRU Abelardo E. Bru	Director
/s/ MARSHA JOHNSON EVANS Marsha Johnson Evans	Director
/s/ DAVID I. FUENTE David I. Fuente	Director
/s/ BRENDA J. GAINES Brenda J. Gaines	Director
/s/ MYRA M. HART Myra M. Hart	Director

/s/ W. SCOTT HEDRICK
W. Scott Hedrick

Director

/s/ KATHLEEN MASON
Kathleen Mason

Director

/s/ MICHAEL J. MYERS
Michael J. Myers

Director

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MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING (Revised)

Management of Office Depot is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers and effected by the company's board of directors, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the company;

provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and

provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Because of inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

As a result of the restatement discussed in Note B to the consolidated financial statements, management reassessed the effectiveness of the company's internal control over financial reporting as of December 30, 2006. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control - Integrated Framework*.

Based on our reassessment, management has determined that, as of December 30, 2006, the company's internal control over financial reporting was not effective due to a material weakness related to the accounting for certain vendor program funds. A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis. This material weakness resulted from deficiencies in the design of internal controls related to ensuring that complete and accurate documentation is provided to individuals responsible for the proper recognition of vendor program funds.

The company's independent registered public accounting firm, Deloitte & Touche LLP, has issued an attestation report on our revised assessment of the company's internal control over financial reporting. Their report appears on the following page.

/s/ STEVE ODLAND

Steve Odland
Chairman, Board of Directors and
Chief Executive Officer

/s/ PATRICIA McKAY

Patricia McKay
Executive Vice President and
Chief Financial Officer

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of Office Depot, Inc.:

We have audited management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting (as revised), that Office Depot, Inc. and subsidiaries (the Company) did not maintain effective internal control over financial reporting as of December 30, 2006, because of the effects of the material weakness identified in management's reassessment, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions. A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our report dated February 12, 2007, we expressed an unqualified opinion on management's assessment that the Company maintained effective internal control over financial reporting. As described in the following paragraph, the Company subsequently identified accounting errors associated with a material weakness, which caused the annual and interim consolidated financial statements to be restated, as described in Note B to the consolidated financial statements as of and for the year ended December 30, 2006. Accordingly, management subsequently revised its assessment of the effectiveness of the Company's internal control over financial reporting and our present opinion on the effectiveness of the Company's internal control over financial reporting as of December 30, 2006, expressed herein is different from that expressed in our previous report.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Company's annual or interim financial statements will not be prevented or detected on a timely basis. The material weakness related to the accounting for certain vendor program funds. This material weakness results from deficiencies in the design of the Company's internal controls related to ensuring that complete and accurate documentation is provided to individuals responsible for the proper recognition of vendor program funds.

In our opinion, management's revised assessment that the Company did not maintain effective internal control over financial reporting as of December 30, 2006 is fairly stated, in all material respects, based on the criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Also in our opinion, because of the effects of the material weakness discussed above on the achievement of the control objectives of the control criteria, the Company has not maintained effective internal control over financial reporting as of December 30, 2006, based on the criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended December 30, 2006 of the Company and our report dated February 12, 2007 (November 15, 2007 as to the effects of the restatement discussed in Note B) expressed an unqualified opinion on those financial statements.

/s/ DELOITTE & TOUCHE LLP

Certified Public Accountants

Fort Lauderdale, Florida

February 12, 2007 (November 15, 2007 as to the effects of the material weakness discussed in Management's Report on Internal Control Over Financial Reporting, as revised)

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of Office Depot, Inc.:

We have audited the accompanying consolidated balance sheets of Office Depot, Inc. and subsidiaries (the Company) as of December 30, 2006 and December 31, 2005 and the related consolidated statements of earnings, stockholders equity, and cash flows for each of the three years in the period ended December 30, 2006. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Office Depot, Inc. and subsidiaries at December 30, 2006 and December 31, 2005, and the results of their operations and their cash flows for each of the three years in the period ended December 30, 2006, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note B, the accompanying 2006 consolidated financial statements have been restated.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of December 30, 2006, based on the criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 12, 2007 (November 15, 2007 as to the effects of the material weakness discussed in Management's Report on Internal Control over Financial Reporting, as revised) expressed an unqualified opinion on management's assessment of the effectiveness of the Company's internal control over financial reporting and an adverse opinion on the effectiveness of the Company's internal control over financial reporting because of the material weakness.

/s/ DELOITTE & TOUCHE LLP

Certified Public Accountants

Fort Lauderdale, Florida

February 12, 2007 (November 15, 2007 as to the effects of the restatement discussed in Note B)

Table of Contents**OFFICE DEPOT, INC.
CONSOLIDATED BALANCE SHEETS***(In thousands, except share and per share amounts)*

	December 30, 2006	December 31, 2005
	(Restated)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 173,552	\$ 703,197
Short-term investments		200
Receivables, net of allowances of \$32,581 in 2006 and \$40,122 in 2005	1,480,316	1,232,107
Inventories, net	1,539,685	1,360,274
Deferred income taxes	131,977	136,998
Prepaid expenses and other current assets	116,931	97,286
Total current assets	3,442,461	3,530,062
Property and equipment, net	1,424,967	1,311,737
Goodwill	1,198,886	881,182
Other assets	491,124	375,544
Total assets	\$ 6,557,438	\$ 6,098,525
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Trade accounts payable	\$ 1,561,784	\$ 1,324,198
Accrued expenses and other current liabilities	1,224,565	979,796
Income taxes payable	135,448	117,487
Short-term borrowings and current maturities of long-term debt	48,130	47,270
Total current liabilities	2,969,927	2,468,751
Deferred income taxes and other long-term liabilities	403,289	321,455
Long-term debt, net of current maturities	570,752	569,098
Minority interest	16,023	
Commitments and contingencies		
Stockholders' equity:		
Common stock — authorized 800,000,000 shares of \$.01 par value; issued and outstanding shares — 426,177,619 in 2006 and 419,812,671 in 2005	4,262	4,198
Additional paid-in capital	1,700,976	1,517,373
Accumulated other comprehensive income	295,253	140,745
Retained earnings	3,370,538	2,867,067
Treasury stock, at cost — 149,778,235 shares in 2006 and 122,787,210 shares in 2005	(2,773,582)	(1,790,162)
Total stockholders' equity	2,597,447	2,739,221

Total liabilities and stockholders' equity	\$ 6,557,438	\$ 6,098,525
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The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

Table of Contents**OFFICE DEPOT, INC.
CONSOLIDATED STATEMENTS OF EARNINGS***(In thousands, except per share amounts)*

	2006	2005	2004
	(Restated)		
Sales	\$15,010,781	\$14,278,944	\$13,564,699
Cost of goods sold and occupancy costs	10,363,437	9,886,921	9,308,560
Gross profit	4,647,344	4,392,023	4,256,139
Store and warehouse operating and selling expenses	3,296,443	3,243,935	3,048,809
Asset impairments	7,450	133,483	11,528
General and administrative expenses	651,696	666,563	665,825
Gain on sale of building	(21,432)		
Operating profit	713,187	348,042	529,977
Other income (expense):			
Interest income	9,828	22,204	20,042
Interest expense	(40,830)	(32,380)	(61,108)
Loss on extinguishment of debt	(5,715)		(45,407)
Miscellaneous income, net	30,565	23,649	17,729
Earnings before income taxes	707,035	361,515	461,233
Income taxes	203,564	87,723	125,729
Net earnings	\$ 503,471	\$ 273,792	\$ 335,504
Net earnings per share:			
Basic	\$ 1.79	\$ 0.88	\$ 1.08
Diluted	1.75	0.87	1.06

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

Table of Contents**OFFICE DEPOT, INC.****CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY***(In thousands, except share amounts)*

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Unamortized Value of Long- Term Incentive Stock Grant	Accumulated Other Comprehensive Income (Loss)	Compre- hensive Income	Retained Earnings	Treasu- ry Stock
Balance at December 27, 2003	398,822,742	\$ 3,988	\$ 1,175,497	\$ (1,362)	\$ 214,764		\$ 2,257,771	\$ (903,000)
Comprehensive income:								
Earnings						335,504	335,504	
Foreign currency translation adjustment					126,603	126,603		
Amortization of gain on hedge					(1,659)	(1,045)		
Comprehensive income						\$ 461,062		
Acquisition of treasury stock								(65,000)
Issuance of long-term incentive stock	105,531	1	1,700	(1,700)				
Redemption of long-term incentive stock	(32,304)		(186)	186				
Exercise of stock options (including income tax benefits and withholding)	6,029,546	60	81,695					
Issuance of stock under employee stock ownership plans			(1,114)					
Under Stock Purchase Plans			27					
Amortization of long-term incentive stock grant				751				
Balance at December 25, 2004	404,925,515	4,049	1,257,619	(2,125)	339,708		2,593,275	(969,000)
Comprehensive income:								
Earnings						273,792	273,792	
Foreign currency translation adjustment					(197,273)	(197,273)		
Amortization of gain on hedge					(1,690)	(1,065)		
Comprehensive income						\$ 75,454		
Acquisition of treasury stock								(815,000)
Issuance of FAS123R			(2,125)	2,125				
Issuance of long-term incentive stock	3,676,229	37	(37)					
Redemption of long-term incentive stock	(19,167)							
Issuance of restricted stock			4,491					(4,491)
Exercise of stock options (including income tax benefits and withholding)	11,118,091	111	206,559					(1,118,091)

Change in number of shares of stock under employee stock purchase plans	112,003	1	969				
Change in number of shares of stock under Employee Stock Purchase Plans			57				
Change in number of shares of stock under Employee Stock Purchase Plans			49,840				
Number of shares of stock under employee stock purchase plans at December 31, 2005	419,812,671	4,198	1,517,373	140,745		2,867,067	(1,790)
Comprehensive income:							
Earnings (Restated)					503,471	503,471	
Foreign currency translation adjustment				150,112	150,112		
Amortization of gain on hedge				(1,659)	(1,659)		
Comprehensive income (Restated)					\$ 651,924		
Deferred pension loss-adoption of AS 158				6,055			
Change in number of shares of treasury stock							(983)
Change in number of shares of long-term incentive stock	287,930	3	(3)				
Change in number of shares of restricted stock			2				
Change in number of shares of stock options (including income benefits and withholding)	5,973,420	60	141,892				
Change in number of shares of stock under employee stock purchase plans	103,598	1	2,064				
Change in number of shares of stock under Employee Stock Purchase Plans			51				
Change in number of shares of stock under Employee Stock Purchase Plans			39,597				
Number of shares of stock under employee stock purchase plans at December 30, 2006 (Restated)	426,177,619	\$ 4,262	\$ 1,700,976	\$ 295,253		\$ 3,370,538	\$ (2,773)

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

Table of Contents**OFFICE DEPOT, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS***(In thousands)*

	2006	2005	2004
	(Restated)		
Cash flows from operating activities:			
Net earnings	\$ 503,471	\$ 273,792	\$ 335,504
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation and amortization	279,005	268,098	269,166
Charges for losses on inventories and receivables	85,610	92,136	87,927
Net earnings from equity method investments	(27,125)	(23,394)	(16,171)
Compensation expense for share-based payments	39,889	49,328	751
Deferred income tax provision	(15,847)	(109,946)	10,889
Gain on disposition of assets	(23,948)	(7,947)	(3,242)
Facility closure costs and impairment charges		47,166	13,263
Asset impairments	7,450	133,483	11,528
Other operating activities	(1,704)	10,563	(4,749)
Changes in assets and liabilities:			
(Increase) decrease in receivables	(128,558)	4,397	(150,821)
Increase in inventories	(155,955)	(49,096)	(114,160)
Net (increase) decrease in prepaid expenses and other assets	(23,212)	24,605	(20,615)
Net increase (decrease) in accounts payable, accrued expenses and deferred credits	287,999	(77,315)	226,595
Total adjustments	323,604	362,078	310,361
Net cash provided by operating activities	827,075	635,870	645,865
Cash flows from investing activities:			
Purchases of short-term investments	(961,450)	(2,037,015)	(67,975)
Sales of short-term investments	961,650	2,196,962	5,000
Acquisitions, net of cash acquired	(248,319)		(7,900)
Capital expenditures	(343,415)	(260,773)	(391,222)
Acquisition of properties held for sale			(19,570)
Proceeds from disposition of assets and deposits received	105,036	48,629	55,061
Other	1,345		
Net cash used in investing activities	(485,153)	(52,197)	(426,606)
Cash flows from financing activities:			
Net proceeds from exercise of stock options and sale of stock under employee stock purchase plans	101,034	175,898	70,592
Tax benefit from employee share-based exercises	43,355	23,024	
Acquisition of treasury stock under approved repurchase plans	(970,640)	(815,236)	(65,578)

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Treasury stock additions from employee related plans	(12,796)		
Proceeds from issuance of borrowings	8,494	24,490	
Payments on long- and short-term borrowings	(58,545)	(38,901)	(11,491)
Redemption of notes			(250,000)
Net cash used in financing activities	(889,098)	(630,725)	(256,477)
Effect of exchange rate changes on cash and cash equivalents	17,531	(43,478)	40,056
Net (decrease) increase in cash and cash equivalents	(529,645)	(90,530)	2,838
Cash and cash equivalents at beginning of period	703,197	793,727	790,889
Cash and cash equivalents at end of period	\$ 173,552	\$ 703,197	\$ 793,727

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Nature of Business: Office Depot, Inc. (Office Depot) is a global supplier of office products and services under the Office Depot® brand and other proprietary brand names. We sell to customers in 42 countries throughout North America, Europe, Asia and Latin America either through wholly-owned entities, majority-owned entities or other ventures covering 34 countries, and through alliances in an additional 8 countries.

Basis of Presentation: The consolidated financial statements of Office Depot and its subsidiaries have been prepared in accordance with accounting principles generally accepted in the United States of America. All intercompany transactions have been eliminated in consolidation. During 2006, we acquired majority, but not complete, ownership in entities in South Korea and China and increased our investment to a controlling position in an entity in Israel. Those entities have been consolidated since the date of acquisition with minority interest presented for the portion we do not own. We also participate in a joint venture selling office products and services in Mexico and Central America that is accounted for using the equity method with their results presented in miscellaneous income, net in the Consolidated Statements of Earnings.

Fiscal Year: Fiscal years are based on a 52- or 53-week period ending on the last Saturday in December. Our fiscal 2005 financial statements consisted of 53 weeks, with the additional week occurring in our fourth quarter; all other periods presented in our consolidated financial statements consisted of 52 weeks.

Estimates and Assumptions: Preparation of these financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect amounts reported in the financial statements and related notes. Actual results may differ from those estimates.

Foreign Currency: Assets and liabilities of international operations are translated into U.S. dollars using the exchange rate at the balance sheet date. Revenues and expenses are translated at average monthly exchange rates. Translation adjustments resulting from this process are recorded in stockholders' equity as a component of other comprehensive income.

Monetary assets and liabilities denominated in a currency other than a consolidated entity's functional currency result in transaction gains or losses from the remeasurement at spot rates at the end of the period. Foreign currency gains and losses that relate to non-operational accounts, such as cash and investments, are recorded in miscellaneous income, net in the Consolidated Statements of Earnings. Foreign currency gains and losses on operational accounts, such as receivables and payables, are included as a component of operating expenses, though historically these amounts have been immaterial.

Cash Equivalents: All short-term highly liquid securities with maturities of three months or less from the date of acquisition are classified as cash equivalents.

Cash Management: Our cash management process generally utilizes zero balance accounts which provide for the reimbursement of the related disbursement accounts on a daily basis. Accounts payable as of December 30, 2006 included \$97 million of disbursements not yet presented for payment drawn in excess of our bank deposit balances which contain legal right to offset provisions.

Short-term Investments: We held no short-term investments at December 30, 2006. When held, investments in debt and auction rate securities were classified as available-for-sale and reported at fair market value, based on quoted market prices using the specific identification method. Interest earned on these funds was used to purchase additional units. The historical cost and fair value of this investment was \$0.2 million at December 31, 2005.

Receivables: Trade receivables, net, totaled \$971.0 million and \$766.5 million at December 30, 2006 and December 31, 2005, respectively. An allowance for doubtful accounts has been recorded to reduce receivables to an amount expected to be collectible from customers. The allowance recorded at December 30, 2006 and December 31, 2005 was \$32.6 million and \$40.1 million, respectively. Receivables generated through a private label credit card program are transferred to financial services companies, a portion of which have recourse to Office Depot. The estimated fair value liability associated with risk of loss is included in accrued expenses.

Our exposure to credit risk associated with trade receivables is limited by having a large customer base that extends across many different industries and geographic regions. However, receivables may be adversely affected by an economic slowdown in the U.S. or internationally. No single customer accounted for more than 5% of our total sales

in 2006, 2005 or 2004.

Other receivables are \$509.3 million and \$465.6 million as of December 30, 2006 and December 31, 2005, respectively, of which \$459.4 million and \$388.2 million are amounts due from vendors under purchase rebate, cooperative advertising and various other marketing programs. These vendor receivables are net of collection allowances of \$20.2 million and \$19.4 million at December 30, 2006 and December 31, 2005, respectively.

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Inventories: Inventories are stated at the lower of cost or market value. The weighted average method is used to determine the cost of a majority of our inventory and the first-in-first-out method is used for international operations.

Income Taxes: Income tax expense is recognized at applicable U.S. or international tax rates. Certain revenue and expense items may be recognized in one period for financial statement purposes and in a different period's income tax return. The tax effects of such differences are reported as deferred income taxes.

U.S. income taxes have not been provided on the remaining undistributed earnings of foreign subsidiaries, which were approximately \$1,377.9 million as of December 30, 2006. We have reinvested such earnings overseas in foreign operations indefinitely and expect that future earnings will also be reinvested overseas indefinitely.

Property and Equipment: Property and equipment additions are recorded at cost. Depreciation and amortization is recognized over their estimated useful lives using the straight-line method. The useful lives of depreciable assets are estimated to be 15-30 years for buildings and 3-10 years for furniture, fixtures and equipment. Computer software is amortized over three years for common office applications, five years for larger business applications and 7-10 years for certain enterprise-wide systems. Leasehold improvements are amortized over the shorter of the terms of the underlying leases or the estimated economic lives of the improvements.

Goodwill and Other Intangible Assets: Goodwill represents the excess of the purchase price and related costs over the value assigned to net tangible and identifiable intangible assets of businesses acquired and accounted for under the purchase method. Accounting rules require that we test at least annually for possible goodwill impairment. Unless conditions warrant earlier action, we perform our test in the fourth quarter of each year using a discounted cash flow analysis that requires that certain assumptions and estimates be made regarding industry economic factors and future profitability. During 2005, we recognized an impairment charge of \$41 million related to goodwill and certain intangible assets held in our Tech Depot subsidiary. A goodwill impairment charge of \$12 million was recognized in 2004 related to our investment in Japan. These charges are included in Asset impairments in the Consolidated Statements of Earnings.

We amortize the cost of other intangible assets over their estimated useful lives unless such lives are deemed indefinite. Amortizable intangible assets are reviewed at least annually to determine whether events and circumstances warrant a revision to the remaining period of amortization. Unless conditions warrant earlier action, intangible assets with indefinite lives are tested annually for impairment during the fourth quarter and written down to fair value as required. During 2005, an impairment charge of approximately \$9.5 million was recorded following a change in the estimated useful life of a trade name; the charge is included in Asset impairment in the Consolidated Statements of Earnings. See Note C for information related to goodwill and intangible asset impairment charges recognized in 2005.

Impairment of Long-Lived Assets: Long-lived assets are reviewed for possible impairment annually or whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Impairment is assessed at the location level, considering the estimated undiscounted cash flows over the asset's remaining life. If estimated cash flows are insufficient to recover the investment, an impairment loss is recognized based on the estimated fair value of the asset less its carrying value and any costs of disposition. Impairment losses of \$2.3 million, \$3.4 million and \$3.9 million were recognized in 2006, 2005 and 2004, respectively, relating to certain under-performing retail stores. Additionally, see Note C for discussion of material asset impairment charges recognized in 2005 and additional charges recognized in 2006.

Facility Closure Costs: We regularly review store performance against expectations and close stores not meeting our investment requirements. Costs associated with store or other facility closures, principally lease cancellation costs, are recognized when the facility is no longer used in an operating capacity or when a liability has been incurred. Store assets are also reviewed for possible impairment, or reduction of estimated useful lives.

Accruals for facility closure costs are based on the future commitments under contracts, adjusted for anticipated sublease and termination benefits. During 2005, we recorded a charge of \$23.2 million relating to leases on retail stores closed as part of a company-wide business review and an additional charge of \$28.4 million to terminate certain existing commitments and to adjust the remaining commitments to current market values. During 2006, we recognized a \$4 million charge based on our transfer to an unrelated third party of risks associated with disposition activities for additional properties. See Note C for related information. The accrued balance relating to our future commitments under operating leases for our closed stores was \$49.8 million and \$69.1 million at December 30, 2006 and

December 31, 2005, respectively.

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Fair Value of Financial Instruments: The estimated fair values of financial instruments recognized in the Consolidated Balance Sheets or disclosed within these Notes to Consolidated Financial Statements have been determined using available market information, information from unrelated third party financial institutions and appropriate valuation methodologies, primarily discounted projected cash flows. However, considerable judgment is required when interpreting market information and other data to develop estimates of fair value. Accordingly, the estimates presented are not necessarily indicative of the amounts that could be realized in a current market exchange.

Short-term Assets and Liabilities: The fair values of cash and cash equivalents, short-term investments, receivables, accounts payable and accrued expenses and other current liabilities approximate their carrying values because of their short-term nature.

Notes Payable: The fair value of the senior notes was determined based on quoted market prices.

Interest Rate Swaps and Foreign Currency Contracts: The fair values of our interest rate swaps and foreign currency contracts are the amounts receivable or payable to terminate the agreements at the reporting date, taking into account current interest and exchange rates. There were no swap agreements in place at the end of 2006.

There were no significant differences between the carrying values and fair values of the financial instruments as of December 30, 2006 and December 31, 2005, except as disclosed below:

	2006		2005	
	Carrying Value	Fair Value	Carrying Value	Fair Value
<i>(Dollars in thousands)</i>				
\$400 million senior notes	\$400,489	\$410,360	\$400,595	\$417,405

Accounting for Stock-Based Compensation: During the third quarter 2005, we adopted Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment*, (FAS 123R) using the modified prospective method.

Prior to our FAS 123R adoption, we applied Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25) when accounting for stock-based employee compensation. Under these rules, the value of certain awards, such as our restricted stock programs, has been included as an expense over the award's vesting period. Our stock option awards, however, were granted with exercise prices equal to the grant date share price resulting in no compensation expense under APB 25.

Had compensation cost for awards under our stock-based compensation plans been determined using the fair value method prescribed by Statement of Financial Accounting Standard (FAS) No. 123, *Accounting for Stock-Based Compensation*, as amended, we would have recognized additional compensation expense. The previously-disclosed pro forma effects are presented below. The pro forma amounts for 2005 reflect the impact for the first six months of the year, prior to the adoption of FAS123R.

<i>(In thousands, except per share amounts)</i>	2005	2004
<i>Net earnings:</i>		
As reported	\$273,792	\$335,504
Pro forma	270,557	315,960
<i>Basic earnings per share:</i>		
As reported	\$ 0.88	\$ 1.08
Pro forma	0.87	1.01
<i>Diluted earnings per share:</i>		
As reported	\$ 0.87	\$ 1.06
Pro forma	0.86	1.00

With our adoption of FAS 123R, we decided to use both the Black-Scholes valuation model and straight-line amortization of compensation expense over the requisite service period of the grant. We will reconsider use of this model if additional information becomes available in the future that indicates another model would be more appropriate for us, or if grants issued in future periods have characteristics that cannot be reasonably estimated using

this model. We have previously estimated forfeitures in our expense calculation for pro forma footnote disclosure and no change in that methodology was made upon adoption of FAS 123R.

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Accrued Expenses: Included in Accrued expenses and other current liabilities on our Consolidated Balance Sheets are accrued payroll-related amounts of approximately \$250 million and \$220 million at December 30, 2006 and December 31, 2005, respectively.

Revenue Recognition: Revenue is recognized at the point of sale for retail transactions and at the time of successful delivery for contract, catalog and internet sales. We use judgment in estimating sales returns, considering numerous factors such as current overall and industry-specific economic conditions and historical sales return rates. Although we consider our sales return reserves to be adequate and proper, changes in historical customer patterns could require adjustments to the provision for returns. We also record reductions to our revenues for customer programs and incentive offerings including special pricing agreements, certain promotions and other volume-based incentives. Revenue from sales of extended warranty service plans is either recognized at the point of sale or over the warranty period, depending on the determination of legal obligor status. All performance obligations and risk of loss associated with such contracts are transferred to an unrelated third-party administrator at the time the contracts are sold. Costs associated with these contracts are recognized in the same period as the related revenue.

Shipping and Handling Fees and Costs: Income generated from shipping and handling fees is classified as revenues for all periods presented. Freight costs incurred to bring merchandise to stores and warehouses are included as a component of inventory and costs of goods sold. Freight costs incurred to ship merchandise to customers are recorded as a component of store and warehouse operating and selling expenses. Shipping costs, combined with warehouse handling costs, totaled \$920.9 million in 2006, \$905.6 million in 2005 and \$911.3 million in 2004. We have been evaluating our presentation of shipping and handling costs in operating expenses and have conformed prior year presentation to the current view of such costs. If we conclude in a future period that presentation in cost of sales is preferable, we will recast prior periods for meaningful comparison.

Advertising: Advertising costs are charged either to expense when incurred or, in the case of direct marketing advertising, capitalized and amortized in proportion to the related revenues over the estimated life of the material, which range from months to up to one year.

Advertising expense recognized was \$575.3 million in 2006, \$549.6 million in 2005 and \$571.5 million in 2004. Prepaid advertising costs were \$25 million as of December 30, 2006 and December 31, 2005.

Pre-opening Expenses: Pre-opening expenses related to opening new stores and warehouses or relocating existing stores and warehouses are expensed as incurred and included in store and warehouse operating and selling expenses.

Self-Insurance: Office Depot is primarily self-insured for workers' compensation, auto and general liability and employee medical insurance programs. Self-insurance liabilities are based on claims filed and estimates of claims incurred but not reported. These liabilities are not discounted.

Comprehensive Income: Comprehensive income represents the change in stockholders' equity from transactions and other events and circumstances arising from non-stockholder sources. Comprehensive income consists of net earnings, foreign currency translation adjustments, realized or unrealized gains (losses) on investment securities that are available-for-sale, deferred pension gains and losses and elements of qualifying cash flow hedges, net of applicable income taxes. As of December 30, 2006, our Consolidated Balance Sheet reflected Accumulated other comprehensive income in the amount of \$295.3 million, which consisted of \$278.2 million in foreign currency translation adjustments, \$11.0 million in unamortized gain on hedge and \$6.1 million in deferred pension loss.

Derivative Financial Instruments: Certain derivative financial instruments may be used to hedge the exposure to foreign currency exchange rate, fuel price change and interest rate risks, subject to an established risk management policy. Financial instruments authorized under this policy include swaps, options, caps, forwards and futures. Use of derivative financial instruments for trading or speculative purposes is prohibited by company policies.

Vendor Arrangements: We enter into arrangements with substantially all of our significant vendors that provide for some form of consideration to be received from the vendors. Arrangements vary, but generally specify volume rebate thresholds, advertising support levels, as well as terms for payment and other administrative matters. The volume-based rebates, supported by a vendor agreement, are estimated throughout the year and reduce the cost of inventory and cost of goods sold during the year. This estimate is regularly monitored and adjusted for current or anticipated changes in purchase levels and for sales activity. Other promotional consideration received is event-based or general support and is recognized as a reduction of cost of goods sold or inventory, as appropriate based on the type

of promotion and the agreement with the vendor.

Reclassifications: Certain prior year amounts have been reclassified to conform to current year presentation.

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New Accounting Standards: In July 2006, the FASB issued 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. While our analysis of the impact this Interpretation is not yet complete, we do not anticipate it will have a material impact on our retained earnings at the time of adoption.

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 our 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 of certain gains and losses that arise during the period but are deferred under pension accounting rules, and 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. At December 30, 2006, we have reported approximately \$6 million of deferred pension losses in accumulated other comprehensive income as a result of this new pronouncement. We do not expect the remaining elements of this Statement to have a material impact on our financial condition, results of operations or cash flows when adopted.

NOTE B RESULTS OF AUDIT COMMITTEE INDEPENDENT REVIEW AND RESTATEMENT OF FINANCIAL STATEMENTS

On October 29, 2007, the company announced that its Audit Committee initiated an independent review principally focused on the accounting for certain vendor program funds. The Audit Committee, with the assistance of independent legal counsel and forensic accountants, assessed the timing of recognition of certain vendor program arrangements. The review, which arose from a whistleblower complaint, revealed that during the period beginning in the third quarter of 2006 through the second quarter of 2007 funds due or received from vendors previously recognized in the current quarter should have been deferred into later periods.

The investigation revealed errors in timing of vendor program recognition and included evidence that some individuals within the company's merchandising organization failed to provide Office Depot's accounting staff with complete or accurate documentation of future purchase or performance conditions in certain vendor programs that would have otherwise required recognition of the related vendor funds to be deferred into future periods in accordance with the company's established practices and accounting principals generally accepted in the United States of America. Based on both qualitative and quantitative factors, the company concluded that the errors were material and the Board of Directors approved a restatement of the company's consolidated financial statements for the periods from the third quarter of 2006 through the second quarter of 2007. As a result, the company has restated the accompanying financial statements as of December 30, 2006 and for the year then ended. In addition to this Amendment No. 1 on Form 10-K/A, the company will file concurrently Forms 10-Q/A for the first and second quarters of 2007.

The effects of the restatement on the consolidated balance sheet as of December 30, 2006 are summarized in the following table:

(In thousands)

	As of December 30, 2006		
	Previously Reported	Adjustments	Restated
Inventories, net	\$ 1,559,981	\$ (20,296)	\$ 1,539,685

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Deferred income taxes	124,345	7,632	131,977
Total current assets	3,455,125	(12,664)	3,442,461
Total assets	6,570,102	(12,664)	6,557,438
Retained earnings	3,383,202	(12,664)	3,370,538
Total stockholders' equity	2,610,111	(12,664)	2,597,447
Total liabilities and stockholders' equity	6,570,102	(12,664)	6,557,438

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Earnings before income taxes was reduced by \$20.3 million for fiscal year 2006. This adjustment resulted from an increase made to cost of goods sold and occupancy costs. The after-tax impact of this correction was a reduction in net earnings of \$12.7 million for fiscal year 2006. The effects of the restatement on the consolidated statements of earnings for fiscal year 2006 are summarized in the following table:

<i>(In thousands)</i>	Fiscal Year Ended December 30, 2006		
	Previously Reported	Adjustments	Restated
Cost of goods sold and occupancy costs	\$ 10,343,141	\$ 20,296	\$ 10,363,437
Gross profit	4,667,640	(20,296)	4,647,344
Operating profit	733,483	(20,296)	713,187
Earnings before income taxes	727,331	(20,296)	707,035
Income taxes	211,196	(7,632)	203,564
Net earnings	516,135	(12,664)	503,471
Earnings per common share:			
Basic	\$ 1.83	\$ (0.04)	\$ 1.79
Diluted	\$ 1.79	\$ (0.04)	\$ 1.75

The effects of the restatement on the consolidated statement of cash flows for fiscal year 2006 is summarized in the following table:

<i>(In thousands)</i>	Fiscal Year Ended December 30, 2006		
	Previously Reported	Adjustments	Restated
Cash flow from operating activities:			
Net earnings	\$ 516,135	\$ (12,664)	\$ 503,471
Deferred Income Taxes	(8,215)	(7,632)	(15,847)
Decrease (increase) in inventories	(176,251)	20,296	(155,955)
Total adjustments	310,940	12,664	323,604

There was no impact to net cash provided by operating activities, net cash used in investing activities and net cash used in financing activities for fiscal year 2006.

The following notes to the consolidated financial statements have been restated to reflect the correction of the accounting error described above: Note G Income Taxes, Note K Earnings Per Share (EPS), Note M Segment Information and Note O Quarterly Financial Data (Unaudited).

NOTE C ASSET IMPAIRMENTS, EXIT COSTS AND OTHER CHARGES

During the third quarter of 2005, we announced a number of material charges relating to asset impairments, exit costs and other operating decisions (the Charges). This announcement followed a wide-ranging assessment of assets and commitments which began in the second quarter of 2005. Through the end of 2006, we had recorded \$345 million of Charges, with \$282 million recognized in 2005 and \$63 million in 2006. Expenses associated with future activities will be recognized as the individual plans are implemented and the related accounting recognition criteria are met. As with any estimate, the amounts may change when expenses are incurred.

These business reviews were performed at a Division level and initially we reported the charges associated with these activities as a component in determining Division operating profit. The financial information used by our management to assess performance of the Divisions for the purpose of resource allocation now excludes the Charges. We believe this measure is an appropriate and useful indicator of the effectiveness of current management activities. Accordingly, we have revised our measure of Division operating profit for external reporting purposes and now report on the Charges at a corporate level. Prior period Division operating profit has been recast to conform to the current presentation. See Note M.

A summary of the Charges and the line item presentation of these amounts in our accompanying Consolidated Statements of Earnings is as follows.

<i>(Dollars in millions)</i>	2006 Amounts	2005 Amounts
Cost of goods sold and occupancy costs	\$ 1	\$ 20
Store and warehouse operating and selling expenses	37	109
Asset impairments	7	133
General and administrative expenses	18	20
 Total pre-tax Charges	 \$63	 282

Of the \$282 million pre-tax charge recognized in 2005, approximately \$133 million related to asset impairments, approximately \$72 million of exit costs and approximately \$77 million of costs associated with termination agreements relating to contracts and surplus leases, accelerated amortization of software and depreciation of assets based on changes in estimated useful lives and the write off of certain property and inventory no longer used or useful based on this business review.

The asset impairment charge of \$133 million included \$83 million related to certain former Kids R Us (KRU) retail store locations acquired in 2004 from Toys R Us, Inc. The performance of many of these locations did not meet initial projections to

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recover the initial asset base that included amounts paid to facilitate a quick entry into certain markets. We also recognized a \$41 million goodwill and other intangible asset charge related to our Tech Depot subsidiary. A change in market conditions for technology products and a shift in that subsidiary's emphasis resulted in lowering our projected cash flows and goodwill was written down to estimated fair value. Also, as part of this business review and to streamline operations, we decided to migrate customers from the Guilbert trade name to Office Depot. The existing trade name intangible asset was tested for impairment and written down approximately \$9 million to the amount that we estimated to be recoverable over the one-year migration plan.

The KRU, Tech Depot and trade name impairment charges are combined in the Consolidated Statement of Earnings on the line item titled Asset impairments. Following the fourth quarter review of goodwill and intangible assets in 2004, we recognized a goodwill impairment charge of approximately \$12 million related to our investment in Japan. Because of its nature, that charge has been presented on this same line for comparative purposes, but was not part of the Charges.

In addition to these significant asset impairment charges, we also recognized significant charges related to exit and other activities. The total exit and other charges recorded in 2005 and anticipated for future periods will be discussed below, as well as where the Charges appear in the Consolidated Statement of Earnings.

We decided to close 25 retail stores (16 in North America and nine internationally), three warehouses (two in North America and one internationally) and consolidate certain international call center and contract operations.

Accordingly, we recognized approximately \$72 million of charges for future lease obligations, severance-related costs, accelerated depreciation, asset write offs and inventory clearance and disposal. Of this total, approximately \$8 million of inventory-related costs were recognized in cost of goods sold, approximately \$61 million in operating and selling expenses and approximately \$3 million in general and administrative expenses.

In addition to these exit costs, we recognized approximately \$77 million of other charges. We terminated certain contractual agreements and adjusted surplus lease property accruals, wrote down and accelerated depreciation on assets based on a decrease in their expected use and accelerated inventory clearance activity in preparation of implementation of a new inventory management system. Of this total, approximately \$12 million was presented as a charge in cost of goods sold, approximately \$48 million in operating and selling expenses and approximately \$17 million in general and administrative expenses.

During 2006, an additional \$63 million associated these projects was recognized as the previously-identified plans were implemented and the related accounting recognition criteria were met. These projects primary related to consolidating and streamlining activities and resulted in charges for severance-related expenses, accelerated depreciation and amortization and other expenses. Of this total, approximately \$1 million was recognized in cost of goods sold, \$7 million as additional KRU store impairments, approximately \$37 million in store and warehouse operating and selling expenses and \$18 million in general and administrative expenses. The operating expense categories are presented in the table below. Some of these activities, such as planned facility closings, will extend into 2007 and 2008. The costs associated with these activities will be recognized in future periods as incurred, or in the case of asset utilization, over the period of remaining estimated useful life.

Exit cost accruals and other Charges related to activities described above are as follows:

<i>(Dollars in millions)</i>	Beginning Balance	Charges Incurred	Cash Payments	Non-cash settlements	Adjustments	Ending Balance
2006						
One-time termination benefits	\$ 6	\$ 22	\$ (21)		\$	\$ 7
Asset write offs and accelerated depreciation		28		(28)		
Lease and contract obligations	23	9	(12)		2	22
Other associated costs	2	4	(2)	(2)		2

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Total	\$ 31	\$ 63	\$ (35)	\$ (30)	\$ 2	\$ 31
	\$999,170	\$1,034,888	\$1,360,616			
Homebuilding borrowings	\$337,649	\$308,697	\$413,110	\$531,671		
Total borrowings(1)	\$346,720	\$347,386	\$461,419	\$574,045		
Stockholders' equity	\$355,059	\$413,370	\$405,145	\$467,743		
Ratio of Homebuilding borrowings to total assets	38.9%	30.9%	39.9%	39.1%		
Ratio of Homebuilding borrowings to capital(2)	48.7%	42.8%	50.5%	53.2%		

(1) Total borrowings includes Homebuilding borrowings and Financial Services borrowings.

(2) Capital includes Homebuilding borrowings and stockholders' equity. Capital excludes Financial Services borrowings.

Discussion of Financial Condition, Liquidity and Capital Resources

Our Homebuilding operations' primary uses of cash have been for land acquisitions, construction and development expenditures, and SG&A expenditures. Our sources of cash to finance these requirements have been primarily cash generated from operations and cash borrowed under our credit facilities. Our Financial Services segment relies primarily on internally generated funds, which include the proceeds generated from the sale of mortgages, and from the mortgage operations' warehouse line of credit to fund our operations.

At September 30, 2003, we had unrestricted cash and cash equivalents of \$41.8 million as compared to \$49.2 million at December 31, 2002.

During the nine months ended September 30, 2003, cash used in operating activities was \$13.5 million as compared to cash used in operating activities of \$7.5 million for the nine months ended September 30, 2002. This increase is primarily a result of an increase in inventory of \$133.7 million, excluding the impact of our acquisitions, as compared to a \$71.7 million increase in inventory for the nine months ended September 30, 2002. This increase in inventory is part of our strategy to increase the number of active communities and our land positions. During the nine months ended September 30, 2003, including the impact of our acquisitions, our controlled homesites increased to 47,618 from 26,320.

Cash used in investing activities was \$90.7 million during the nine months ended September 30, 2003, as compared to \$6.3 million during the nine months ended September 30, 2002. The increase in the use of cash in investing activities is primarily due to the acquisitions made during the nine months ended September 30, 2003, and \$18.1 million in additional consideration.

On February 28, 2003, we acquired the net assets of The James Construction Company, a homebuilder operating in the greater Denver, Colorado area, for approximately \$22.0 million in cash. In addition, we are obligated to pay an additional \$1.4 million over a two year period.

On February 6, 2003, we acquired the net assets of Trophy Homes, Inc., a homebuilder operating in Las Vegas, Nevada, and certain homesites for approximately \$36.2 million in cash. In addition, if certain targets are met regarding home deliveries during 2003 and 2004, we will be obligated to pay up to an

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additional \$2.5 million to the sellers over a two year period. Of this amount, we paid \$1.3 million of additional consideration during the nine months ended September 30, 2003.

As a result of the increases in our land positions and the recent acquisitions, our ratio of Homebuilding borrowings to total assets was 39.1% at September 30, 2003, as compared to 37.6% at September 30, 2002. Our ratio of Homebuilding borrowings to capital was 53.2% at September 30, 2003 as compared to 48.8% at September 30, 2002.

On February 3, 2003, we issued \$100.0 million of 9% Senior Notes due 2010 at a price of 94.836% of the principal amount plus interest accrued since January 1, 2003. The net proceeds of approximately \$93.6 million were primarily used to repay amounts outstanding under our revolving credit facility. The February 2003 Senior Notes were issued pursuant to an indenture with substantially the same terms and conditions as the indenture pursuant to which we issued the June 2002 Senior Notes.

On April 22, 2003, we issued an additional \$35.0 million of our 10 3/8% Senior Subordinated Notes due 2012 at a price of 98.5% of the principal amount plus interest accrued since January 1, 2003. The net proceeds of approximately \$34.5 million were used to repay the amounts outstanding under our credit facility. These additional debt securities were issued under the same indenture pursuant to which we issued our June 2002 Senior Subordinated Notes.

Interest on our outstanding senior notes and senior subordinated notes is payable on January 1 and July 1 of each year. The senior notes are guaranteed by all of our material domestic subsidiaries. The senior notes rank *pari passu* in right of payment with all of our existing and future unsecured senior debt and senior in right of payment to the senior subordinated notes and any future subordinated debt. The senior subordinated notes rank *pari passu* in right of payment with all of our existing and future unsecured senior subordinated debt and are guaranteed on a senior subordinated basis by all of our material domestic subsidiaries. The indentures governing the senior and senior subordinated notes require us to maintain a minimum net worth and place certain restrictions on our ability, among other things, to incur additional debt, pay or make dividends or other distributions, sell assets, enter into transactions with affiliates, and merge or consolidate with other entities. The interest rates on our outstanding senior and senior subordinated notes are higher than the collective interest rates on the obligations that were repaid. As a result of the higher interest rates and the assumption of approximately \$75 million of Technical Olympic debt in connection with the merger of Engle Holdings, we anticipate that interest incurred will exceed the amounts which would have been incurred under the prior borrowings. Therefore, the increased interest incurred will have an effect on gross margins in future periods.

On April 4, 2003, we amended our revolving credit facility to increase the amount we are permitted to borrow. Our revolving credit facility permits us to borrow to the lesser of (i) \$315.0 million, or (ii) our borrowing base (calculated in accordance with the revolving credit facility agreement) minus our outstanding senior debt, and to issue letters of credit up to \$80.0 million. In addition, we have the right to increase the size of the facility to provide for up to an additional \$10.0 million of revolving loans, subject to meeting certain requirements. The revolving credit facility expires on June 26, 2005. As of September 30, 2003, we had drawn down \$45.0 million and had issued letters of credit of \$67.8 million and as a result, had \$202.2 million in availability under the revolving credit facility. Loans outstanding under the facility may be base rate loans or Eurodollar loans, at our election. Base rate loans accrue interest at a rate per annum equal to (i) an applicable margin plus (ii) the higher of (A) Citibank, N.A.'s base rate, (B) 0.5% plus the three week average of the reserve-adjusted three-month certificate of deposit rate and (C) 0.5% plus the Federal Funds Rate. Eurodollar loans accrue interest at a rate per annum equal to (i) an applicable margin plus (ii) the reserve-adjusted Eurodollar rate for the interest period. Applicable margins will be adjusted based on the ratio of our liabilities to our tangible worth. At September 30, 2003, our loans outstanding under the revolving credit facility accrued interest at a rate of 5.12% per annum. The revolving credit facility requires us to (1) maintain specified financial ratios regarding leverage, interest coverage, consolidated tangible net worth and certain operational measurements and (2) satisfy certain financial condition tests. The revolving credit facility also places certain restrictions on, among other things, our ability to incur additional debt or liens, pay or make dividends or other

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distributions, sell assets, enter into transactions with affiliates and merge or consolidate with other entities. The revolving credit facility is secured by a first-priority perfected lien on all capital stock of subsidiaries owned by us. Our obligations under the revolving credit facility are guaranteed by all our domestic subsidiaries (subject to certain limited exceptions).

To fund the origination of residential mortgage loans, our subsidiary, Preferred Home Mortgage Company (Preferred Home) entered into a \$65.0 million revolving warehouse line of credit, which we refer to as our warehouse line of credit. The warehouse line of credit is comprised of (1) a credit facility (the PHMC Credit Facility) providing for revolving loans of up to \$40.0 million, subject to meeting borrowing base requirements based on the value of collateral provided and (2) mortgage loan purchase and sale agreements (the Purchase Facility) which provide for the purchase by the lender of up to \$25.0 million in mortgage loans generated by Preferred Home. At no time may the amount outstanding under the facility plus the amount of purchased loans pursuant to the purchase and sale agreements exceed \$65.0 million. The warehouse line of credit expires on November 21, 2003. As of September 30, 2003, we had \$42.4 million outstanding under the warehouse line of credit. The PHMC Credit Facility bears interest, at Preferred Home's option, at either, (1) the Federal Funds rate plus 1.375% or (2) the Eurodollar rate plus 1.25%. Amounts outstanding under the Purchase Facility bear interest at the Eurodollar rate plus 1.125%. As of September 30, 2003, our loans outstanding under the warehouse line of credit accrued interest at a blended rate of 2.46% per annum. The warehouse line of credit requires Preferred Home to maintain certain financial ratios and minimums. The warehouse line of credit is guaranteed by us and secured by funded mortgages which are pledged as collateral.

We believe that as a result of our offering of senior notes in February 2003 and senior subordinated notes in April 2003 and the increase in our revolving credit facility, we will have adequate financial resources, including cash from operations and availability under the revolving credit facility and the warehouse line of credit, to meet our current and anticipated working capital and land acquisition and development needs based on current market conditions. However, there can be no assurance that the amounts available from such sources will be sufficient. If we identify new acquisition opportunities, or if our operations do not generate sufficient cash from operations at levels currently anticipated, we may need to seek additional debt or equity financing to operate and expand our business.

At September 30, 2003, the amount of our annual debt service payments was \$49.9 million. This amount included annual debt service payments on the senior and senior subordinated notes of \$46.2 million and interest payments on the revolving credit facility, the warehouse line of credit, and other notes of \$3.7 million based on the balances outstanding as of September 30, 2003. The amount of our annual debt service payments on the revolving credit facility fluctuates based on the principal outstanding under the facility and the interest rate. An increase or decrease of 1% in interest rates will change our annual debt service payments by \$0.9 million per year. The revolving credit facility terminates in June 2005 at which time we will be required to repay all outstanding principal. Under certain circumstances, we may extend the facility in one-year increments, for up to two additional years.

Backlog

As of September 30, 2003, we had 3,327 homes in backlog representing \$902.9 million in revenue, as compared to 2,337 homes in backlog representing \$659.9 million in revenue as of September 30, 2002. This increase in revenue in backlog of 37% is primarily attributable to the homes in backlog of our recent acquisitions as well as increased sales activity in several of our existing markets. Our average selling price of homes in backlog has declined slightly to \$271,000 from \$282,000 as a result of our product diversification.

Dividends

We did not declare or pay any dividends during Fiscal Year 2002 or the first nine months of 2003. We paid a dividend of \$0.54 per share of common stock (on a pre-restatement basis and \$0.22 per share on a restated basis) in Fiscal Year 2001 (\$6.2 million in the aggregate). We did not pay any cash

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dividends on our common stock in Fiscal Year 2000. Prior to its merger with us, Engle Homes made net distributions of \$4.8 million during Fiscal Year 2002, \$29.5 million during Fiscal Year 2001 and \$0.4 million during Fiscal Year 2000.

Recent Accounting Pronouncements

In April 2002, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 145, Reporting Gains and Losses from Extinguishment of Debt, which rescinded SFAS No. 4, No. 44, and No. 64 and amended SFAS No. 13. The new standard addresses the income statement classification of gains or losses from the extinguishment of debt and criteria for classification as extraordinary items. We adopted SFAS No. 145 during 2002.

In November 2002, the FASB issued FASB Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others (FIN 45). FIN 45 elaborates on the existing disclosure requirements for most guarantees, including loan guarantees such as standby letters of credit. It also clarifies that at the time a company issues a guarantee, the company must recognize an initial liability for the fair value, or market value, of the obligations it assumes under the guarantee and must disclose that information in its interim and annual financial statements. The provisions related to recognizing a liability at inception of the guarantee for the fair value of the guarantor's obligations do not apply to product warranties. The initial recognition and initial measurement provisions apply on a prospective basis to guarantees issued or modified after December 31, 2002. The adoption of the initial recognition and initial measurement provisions of FIN 45 did not have a material effect on our financial position or results of operations.

In December 2002, the FASB issued SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure, which amends SFAS No. 123. The new standard provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. It also requires prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the affect of the method used on reported results. We have not elected to change to the fair value based method of accounting for stock-based employee compensation. We adopted the disclosure provisions of SFAS No. 148 in our first fiscal quarter ending March 31, 2003.

In January 2003, the FASB issued FASB Interpretation (Interpretation) No. 46, Consolidation of Variable Interest Entities. Interpretation No. 46 is applied immediately to variable interest entities (VIEs) created after January 31, 2003, and with respect to variable interests held before February 1, 2003, Interpretation No. 46 will apply beginning with interim and annual periods ending on or after December 15, 2003. Interpretation No. 46 addresses consolidation by business enterprises of VIEs which have one or both of the following characteristics: (1) the equity investment at risk is not sufficient to permit the entity to finance its activities without additional subordinated support from other parties, which is provided through other interests that will absorb some or all of the expected losses of the entity; or (2) the equity investors lack one or more of the following essential characteristics of a controlling financial interest: (a) the direct or indirect ability to make decisions about the entities' activities through voting rights or similar rights; or (b) the obligation to absorb the expected losses of the entity if they occur, which makes it possible for the entity to finance its activities; or (c) the right to receive the expected residual returns of the entity if they occur, which is the compensation for the risk of absorbing the expected losses.

Generally, in the homebuilding industry, homebuilders will enter into option contracts for the purchase of land or homesites with land sellers and third-party financial entities, some of which may qualify as VIEs, as a method of acquiring developed homesites. We believe that Interpretation No. 46 must be evaluated as it relates to these and similar types of arrangements. In applying Interpretation No. 46 to our homesite option contracts, estimates regarding cash flows and other assumptions have to be made. We believe that our critical assumptions are reasonable based on historical evidence and industry practice. Based on our analysis of contracts entered into after January 31, 2003, we determined that we are

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the primary beneficiary of certain of these homesite option contracts. Consequently, Interpretation No. 46 requires us to consolidate the assets (homesites) at their fair value, although (1) we have no legal title to the assets, (2) our maximum exposure to loss is limited to the deposits or letters of credits placed with these entities, and (3) creditors, if any, of these entities have no recourse against us. The effect of the consolidation was to increase inventory by \$55.5 million, excluding deposits of \$4.6 million which had been previously recorded, with a corresponding increase to consolidated land bank obligations in the accompanying consolidated statement of financial condition as of September 30, 2003.

In May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity. SFAS No. 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003 (our quarter ending September 30, 2003) with the exception of an indefinite deferral relating to application to limited life entities. We do not believe that the implementation of SFAS No. 150 will have a material impact on our financial condition, results of operations or cash flows.

Seasonality of Operations

The homebuilding industry tends to be seasonal, as generally there are more homes sold in the spring and summer months when the weather is milder, although the rate of sales contracts for new homes is highly dependent on the number of active communities and the timing of new community openings. We operate primarily in the southwest and southeast, where weather conditions are more suitable to a year-round construction process than in other parts of the country. Because new home deliveries trail new home contracts by several months, we typically have a greater percentage of home deliveries in the fall.

Inflation

We may be adversely affected during periods of high inflation, primarily because of higher land and construction costs. In addition, inflation may result in higher mortgage interest rates, which may significantly affect the affordability of permanent mortgage financing for prospective purchasers. Inflation also increases our interest costs. We attempt to pass through to our customers any increases in our costs through increased selling prices and, to date, inflation has not had a material adverse effect on our results of operations. However, there is no assurance that inflation will not have a material adverse impact on our future results of operations.

Quantitative and Qualitative Disclosures About Market Risk

As a result of our notes offerings, at September 30, 2003, \$485.0 million of our outstanding borrowings are based on fixed interest rates. We are exposed to market risk primarily related to potential adverse changes in interest rates on our existing construction loans, warehouse line of credit, and revolving credit facility. The interest rates relative to these borrowings fluctuate with the prime and LIBOR lending rates, both upwards and downwards. We have not entered into derivative financial instruments for trading or speculative purposes. As of September 30, 2003, we had an aggregate of approximately \$94.2 million drawn under our bank loan arrangements that are subject to changes in interest rates. An increase or decrease of 1% in interest rates will change our annual debt service payments by \$0.9 million per year as a result of our bank loan arrangements that are subject to changes in interest rates.

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The following table presents the future principal payment obligations and weighted average interest rates associated with our long-term debt instruments assuming our actual level of long-term debt indebtedness as of September 30, 2003:

	Expected Maturity Date						Fair Value
	(in thousands)						
	2003	2004	2005	2006	2007	Thereafter	
Liabilities							
Long-term debt							
Fixed rate (9.0%)						\$ 300,000	\$ 322,680
Fixed rate (10 3/8%)						\$ 185,000	\$ 189,181
Variable rate, revolving loan (5.12% at September 30, 2003)			\$ 45,000				\$ 45,000
Variable rate, warehouse line of credit (2.64% at September 30, 2003)	\$ 42,374						\$ 42,374
Other homebuilding borrowings (at various interest rates ranging from 4.0% to 6.0%)	\$ 811	\$ 392	\$ 5,633				\$ 6,836

Our operations are interest rate sensitive. Overall housing demand is adversely affected by increases in interest rates. If mortgage interest rates increase significantly, this may negatively affect the ability of homebuyers to secure adequate financing. Higher interest rates will adversely affect our revenues, gross margins, and net income. Higher interest rates also increase our borrowing costs because, as indicated above, our bank loans will fluctuate with the prime and LIBOR lending rates, both upwards and downwards.

We may be adversely affected during periods of high inflation, primarily because of higher land and construction costs. In addition, inflation may result in higher mortgage interest rates, which may significantly affect the affordability of permanent mortgage financing for prospective purchasers. Inflation also increases our interest costs. We attempt to pass through to our customers any increases in our costs through increased selling prices and, to date, inflation has not had a material adverse effect on our results of operations. However, there is no assurance that inflation will not have a material adverse impact on our future results of operations.

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BUSINESS

We design, build and market high quality detached single-family residences, town homes, and condominiums. We operate in markets characterized by strong population and income growth. Currently we conduct homebuilding operations in 14 metropolitan markets, located in four major geographic regions: Florida, the Mid-Atlantic, Texas and the West.

For the twelve months ended December 31, 2002, we delivered 5,085 homes, with an average sales price of \$265,000, and generated approximately \$1.3 billion in revenues from home sales and \$67.0 million in income from continuing operations. For the nine months ended September 30, 2003, we delivered 4,332 homes, with an average sales price of \$262,000, and generated approximately \$1.1 billion in revenues from home sales and \$62.4 million in income from continuing operations. Our backlog of homes at September 30, 2003 was 3,327 homes under contract, representing \$902.9 million in expected revenues.

We market our homes to a diverse group of homebuyers, including first-time homebuyers, move-up homebuyers, homebuyers who are relocating to a new city or state, buyers of second or vacation homes, active-adult homebuyers and homebuyers with grown children who want a smaller home (empty-nesters). Our homes are marketed under various brand names, including Engle Homes, Newmark Homes, Fedrick, Harris Estate Homes, Marksman Homes, D.S. Ware Homes, Masonry Homes, Trophy Homes and James Company. As of September 30, 2003, we either owned or had options to acquire 47,618 homesites, and we were actively marketing in 206 communities.

As part of our objective to provide homebuyers a seamless home purchasing experience, we have developed, and are expanding, our complementary financial services business. As part of this business, we provide mortgage financing and closing services and offer title, homeowners and other insurance products. Our mortgage financing operation s revenues consist primarily of origination and premium fee income, interest income and the gain on the sale of the mortgages, as we sell substantially all of our mortgages and the related servicing rights to third-party investors. Our mortgage financing services are used primarily by buyers of our homes, although we also offer these services to existing homeowners refinancing their mortgages. By comparison, our closing services and our insurance agency operations are used by our homebuyers as well as a broad range of other clients purchasing or refinancing residential or commercial real estate.

Company History

Our predecessor company was founded in Houston, Texas in 1983. Our company was formed in 1994 as a Nevada corporation under the name Newmark Homes Corp. We completed our initial public offering of common stock in March 1998. In March 2001, we changed the state of our incorporation from Nevada to Delaware.

In December 1999, Technical Olympic, Inc., which we refer to as Technical Olympic, acquired 80% of our common stock. At the time it acquired us, Technical Olympic was a wholly-owned subsidiary of Technical Olympic (UK) Ltd., an entity formed under the laws of the United Kingdom, which was a wholly-owned subsidiary of Technical Olympic S.A., a publicly-traded Greek corporation. In October 2003, as part of a restructuring transaction, all of the shares of Technical Olympic were sold by Technical Olympic (UK) Ltd. to Technical Olympic, S.A. Technical Olympic was then merged with and into TOI, LLC, a newly formed wholly-owned subsidiary of ours. As part of the merger, Technical Olympic S.A. acquired the shares of our common stock. The restructuring was accomplished to eliminate global tax inefficiencies resulting from a double holding company structure.

On April 15, 2002, we sold the stock of our wholly-owned subsidiary, Westbrooke Acquisition Corp., to Standard Pacific Corp. for consideration consisting of \$41.0 million in cash and the repayment by Standard Pacific of \$54.4 million of Westbrooke s debt. Westbrooke Acquisition and its subsidiaries build homes in South Florida under the name of Westbrooke Homes.

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On June 25, 2002, Engle Homes Holdings Corp., a wholly-owned subsidiary of our then majority stockholder, Technical Olympic, merged with and into us and we changed our name to Technical Olympic USA, Inc.

On October 4, 2002, we acquired the net assets of D.S. Ware Homes LLC, a homebuilder operating in Jacksonville, Florida, for \$35.6 million in cash. In addition, because certain earnings targets were met for the five-month period after the closing, we paid an additional \$5.2 million in cash to the sellers in April 2003.

On November 18, 2002, we acquired the net assets of Masonry Homes, Inc., a homebuilder operating in the northwestern suburbs of Baltimore, Maryland and southern Pennsylvania, for \$17.1 million in cash. In addition, if certain targets are met regarding home deliveries, the development and/or subdivision of certain homesites and earnings for the 2003 and 2004 fiscal years, we will be obligated to pay up to an additional \$21.3 million in cash to the sellers over a two-year period, of which \$11.3 million was paid on February 4, 2003.

On February 6, 2003, we acquired the net assets of Trophy Homes, Inc., a homebuilder operating in Las Vegas, Nevada and certain homesites for approximately \$36.2 million in cash. In addition, if certain targets are met regarding home deliveries during 2003 and 2004, we will be obligated to pay up to an additional \$2.5 million over a two year period.

On February 28, 2003, we acquired the net assets of The James Construction Company, a homebuilder operating in the greater Denver, Colorado area, for approximately \$22.0 million in cash. In addition, we are obligated to pay an additional \$1.4 million over a two year period.

Competitive Strengths

High Growth Markets

We believe that by focusing our homebuilding operations in high growth markets, we are well positioned to expand our business and maximize our financial returns. We operate in five of the eight fastest growing states in the United States, based on population growth from 1990 to 2000. The average median population growth in the eight states where we operate was 28.1% from 1990 to 2000, as compared to the U.S. average of 13.1%. In addition, each of the states in which we operate has demonstrated a history of solid economic growth. These eight states had an average median income growth of 13.3%, as compared to the U.S. average of 4.0%, from 1989 to 1999. We expect that these growth trends will increase future housing demand in our markets. Additionally, based on our relative position in each of these markets, we believe we have the opportunity to expand our operations.

Geographic and Customer Diversification

We operate in 14 geographically diverse markets. For the twelve months ended December 31, 2002, none of our metropolitan markets represented more than 18% of our total revenues. Within our markets, we target a diverse customer base including first-time, move-up, relocating, active-adult and empty-nester homebuyer segments. For the twelve months ended September 30, 2003, we generated 43% of our revenues from home sales from homes in the \$200,000 to \$300,000 price range, 29% of our revenues from home sales from homes in the \$300,000 to \$400,000 price range, 16% of our revenues from home sales from homes in the under \$200,000 price range, and 12% of our revenues from home sales from homes in the over \$400,000 price range. We believe that this diversification protects us from downturns in any one market or price segment and provides us with additional growth opportunities.

Experienced Management Team

We balance our local expertise and focus with a seasoned and professional senior management team. Our regional and divisional managers have an average of more than 20 years of homebuilding experience in their local markets. As a result, they have developed in-depth market expertise and familiarity with their customers and subcontractors. In addition, as a result of their long-standing relationships with local

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land sellers and developers, our regional and divisional managers are well-positioned to acquire premium land and homesites. Our senior corporate managers have an average of more than 18 years of experience in the homebuilding business and have a successful track record of delivering strong results in varying homebuilding cycles. The experience and depth of our management team provides us the capability to quickly evaluate and successfully capitalize on market opportunities and adjust to changing national, regional and local business conditions.

Strong Land Positions and Disciplined Acquisition Strategy

Land is our key raw material and one of our most valuable assets. We believe that by acquiring land and homesites in premier locations, we enhance our competitive standing and reduce our exposure to economic downturns. We believe that homes in premier locations continue to attract homebuyers in both strong and weak economic conditions. We consider that our disciplined acquisition strategy of balancing homesites and land we own and those we can acquire under option contracts provides us access to a substantial supply of quality homesites and land while conserving our invested capital and optimizing our returns. Generally, we acquire only homesites and entitled land suitable for homesite development and residential construction.

Strong Brand Recognition and Customer Service

We market our homes under various brand names, including Engle Homes, Newmark Homes, Fedrick, Harris Estate Homes, Marksman Homes, D.S. Ware Homes, Masonry Homes, Trophy Homes and James Company. We believe our brands are widely recognized in the markets in which we operate for providing quality homes in desirable locations and enjoy a solid reputation among potential homebuyers. We believe that customer satisfaction enhances our reputation for quality and service and leads to significant repeat and referral business. In our industry, customer satisfaction is based in large part on our ability to respond promptly and courteously to homebuyers before, during and after the sale of our homes. As part of our customer service program, we conduct pre-delivery inspections to promptly address any outstanding construction issues and contract independent third parties to conduct periodic post-delivery evaluations of the customer's satisfaction with their home, as well as the customer's experience with our sales personnel, construction department and title and mortgage services.

Business Strategies

Capitalize on Growth Potential in Our Current Markets

We believe that a significant portion of our future growth will stem from our ability to increase our homes sales and capture additional market share within our current markets. Currently, we conduct homebuilding operations in 14 metropolitan markets, each of which is highly fragmented with numerous smaller homebuilders. Our reputation as a high quality homebuilder combined with our financial resources gives us an advantage over many smaller homebuilders with whom we compete. Based on management estimates, we are positioned as a top-five homebuilder in three of our current markets. Consequently, we have an opportunity to significantly strengthen our market position by expanding our product offerings and increasing the number of our active selling communities. Our current markets have demonstrated solid income and population growth trends. As a result, we expect that strong demand for new housing in our current markets will also contribute to our growth. By leveraging our current operations, we believe that we will, over time, maximize our financial returns, strengthen our margins and increase our revenues and profitability.

Implement Performance Improvement and Best Practices Initiatives

As part of our goal of strengthening our financial returns, we continuously monitor and evaluate our systems, practices and procedures in order to improve our operations. To assist with the measurements of our results and the results of our operating divisions, we utilize a detailed Performance Improvement Plan that focuses on techniques to enhance operating efficiencies. We have, and will continue to,

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implement best practices across our operating divisions and believe that this operating strategy has allowed, and will continue to allow, us to:

implement innovative information systems to, among other things, monitor homebuilding production, scheduling and budgeting and facilitate communication among our divisions with respect to the design and construction of our homes;

reduce the time necessary to complete each stage in the homebuilding process;

effectively manage our inventory of homes;

use our purchasing power to achieve volume discounts and the best possible service from our vendors; and

achieve more favorable pricing of homesite premiums and options.

Grow Our Financial Services Business

Our financial services operations require minimal capital investment and are highly profitable because of the high margins we obtain from our mortgage financing operation and the high volume of transactions generated from our title insurance and closing services operations. We believe that these financial services complement our homebuilding operations and provide homebuyers a seamless home purchasing experience. For the nine months ended September 30, 2003, approximately 58% of our homebuyers used the services of our mortgage business, while 81% of our homebuyers used our title and closing services and 21% used our insurance agencies to obtain insurance. We believe that we have an opportunity to grow our financial services business by:

increasing the percentage of our homebuyers who use our financial services;

marketing our financial services more actively to buyers of homes built by other homebuilders, including smaller homebuilders that do not provide their own financial services; and

offering additional services that complement our existing financial services in all our markets.

Selectively Expand Into New Markets

We intend to supplement our primary growth strategy of expansion in our current markets with a disciplined, financial return oriented approach to entering new markets. We will focus on entering metropolitan areas that have favorable homebuilding characteristics, including availability of strong management with local market expertise as well as solid income and population growth trends, significant single-family home permit activity, a diversified economy and an adequate supply of obtainable homesites. We believe this long-term emphasis on geographic diversification across a range of growing markets with strong fundamentals will enable us to minimize our exposure to adverse economic conditions, seasonality and housing cycles in individual local markets. We will enter new markets through strategic acquisitions of other homebuilders and, to the extent we enter new markets that complement and/or are in close proximity to our current markets, we will utilize our existing management expertise and resources to establish operations.

Homebuilding Operations

Markets

We operate in 14 metropolitan markets located in four major geographic regions: Florida; the Mid-Atlantic; Texas; and the West. For the twelve months ended December 31, 2002, none of our metropolitan markets represented more than 18% of our total revenues. We select our target geographic markets based on, among other things, historical and projected population growth, projected job growth, regional economic conditions, availability of strong management with local expertise, land availability, single-family home permit activity and price, the local land development process, consumer tastes, competition, housing inventory and secondary home sales activity.

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Florida. Our Florida region is comprised of four metropolitan markets: Jacksonville; Orlando; Southeast Florida, which is comprised of Broward, Palm Beach, Martin, Port St. Lucie and Indian River Counties; and Southwest Florida, which is comprised of Fort Myers and Naples. We conduct business in our Orlando, Southeast Florida and Southwest Florida markets under the Engle Homes brand name. We entered the Jacksonville market in October 2002 through the acquisition of D.S. Ware Homes and continue to conduct business in Jacksonville under the D.S. Ware Homes brand name. For the twelve months ended December 31, 2002, we delivered 2,024 homes in Florida, generating \$496.7 million, or 36.8% of our revenues from home sales. For the nine months ended September 30, 2003, we delivered 1,628 homes in Florida, generating \$394.5 million, or 34.8% of our revenues from home sales for the period.

Mid-Atlantic. Our Mid-Atlantic region is comprised of three metropolitan markets: Baltimore, Maryland/Southern Pennsylvania; Nashville, Tennessee; and Northern Virginia. We entered the Baltimore market in November 2002 through the acquisition of Masonry Homes and continue to conduct business in this market under the Masonry Homes brand name. We conduct business in Nashville under the Newmark Homes and Fedrick, Harris Estate Homes brand names. We conduct business in Northern Virginia under the Engle Homes brand name. For the twelve months ended December 31, 2002, we delivered 564 homes in our Mid-Atlantic region generating \$197.8 million, or 14.7% of our revenues from home sales. For the nine months ended September 30, 2003, we delivered 472 homes in the Mid-Atlantic region, generating \$153.6 million, or 13.5% of our revenues from home sales for the period.

Texas. Our Texas region is comprised of four metropolitan markets: Austin; Dallas/Ft. Worth; Houston; and San Antonio. We conduct business in all of our markets in Texas under the Newmark Homes brand name. We also conduct business under the Engle Homes brand name in the Dallas/Fort Worth market and under the Fedrick, Harris Estate Homes brand name in Austin, Dallas and Houston. We build in both mini-master and master plan communities in Texas. In addition, to meet varying local demand in each of our Texas markets, a considerable number of our homes in the Texas market are built as speculative homes, which means we build the homes prior to having sold them. The number of speculative homes we build in any given community or market is influenced by local market factors, such as new employment opportunities, significant job relocations, housing demand, local market customs and the length of time we have operated in the market. For the twelve months ended December 31, 2002, we delivered 1,539 homes in Texas, generating \$397.1 million, or 29.4% of our revenues from home sales. For the nine months ended September 30, 2003, we delivered 1,127 homes in Texas, generating \$294.8 million, or 26.0% of our revenues from home sales for the period.

West. Our West region is comprised of three metropolitan markets: the Colorado Front Range, which is comprised of Denver, Boulder and Colorado Springs; Las Vegas, Nevada; and Phoenix, Arizona. In our Colorado market we conduct business under the Engle Homes brand name and recently expanded our market by the acquisition of The James Construction Company. We continue to conduct business in the greater Denver area under The James Company brand name. Recently, we entered into the Las Vegas market through the acquisition of Trophy Homes. We continue to conduct business in Las Vegas under the Trophy Homes brand name. In the Phoenix market, we conduct business under the Engle Homes brand name. For the twelve months ended December 31, 2002, we delivered 958 homes in our West region generating \$258.1 million, or 19.1% of our revenues from home sales. For the nine months ended September 30, 2003, we delivered 1,105 homes in the West region, generating \$291.1 million, or 25.7% of our revenues from home sales for the period.

Product Mix

We select our product mix in a particular geographic market based on the demographics of the market, demand for a particular product, margins and the economic strength of the market. We regularly review our product mix in each of our markets so that we can quickly respond to market changes and opportunities.

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For the twelve months ended September 30, 2003, we generated 43% of our revenues from home sales from homes in the \$200,000 to \$300,000 price range, 29% of our revenues from home sales from homes in the \$300,000 to \$400,000 price range, 16% of our revenues from home sales from homes in the under \$200,000 price range, and 12% of our revenues from home sales from homes in the over \$400,000 price range.

Land and Homesites

Types of Land and Homesites. Generally, we only acquire entitled land or homesites in our homebuilding operations. Land is entitled when all requisite residential zoning has been obtained for it. We attempt to acquire entitled homesites that have water and sewage systems, streets and other infrastructure in place (we refer to these homesites as developed homesites) because these homesites are ready to have houses built on them. Before we can build a house on an entitled homesite that is not developed, the necessary infrastructure must be put in place. We generally acquire homesites that are located adjacent to or near our other homesites in a community, which enables us to build and market our homes more cost efficiently than if the homesites were scattered throughout the community. Cost efficiencies arise from economies of scale, such as shared marketing expenses and project management.

Land Acquisition Policies. We have adopted strict land acquisition policies and procedures that cover all homesite acquisitions, including homesites acquired through option contracts. These policies and procedures impose strict standards for assessing all proposed land purchases with the goal of minimizing risk and maximizing our financial returns.

Initially, our experienced management teams in each of our divisions conduct extensive analysis on the local market to determine if we want to enter, or expand, our operations in that market. As part of this analysis, we review a variety of factors, including:

- historical and projected population and employment rates for the surrounding area;
- demographic information such as age, education and economic status of the homebuyers in the area;
- suitability for development within two to four years of acquisition;
- desirability of location, including proximity to metropolitan area, local traffic corridors and amenities; and
- prices of comparable new and resale houses in the area.

We then evaluate and identify specific homesites in desirable locations that are consistent with our strategy for the particular market, including the type of home and anticipated sales price that we wish to offer in the community. In addition, we review:

- estimated costs of completed homesite development;
- current and anticipated competition in the area, including the type and anticipated sales price of homes offered by our competitors;
- opportunity to acquire additional homesites in the future, if desired; and
- results of financial analysis, such as projected profit margins and return on invested capital.

In addition, we conduct extensive environmental due diligence, including on-site inspection and soil testing, and confirm that the land has the necessary zoning and other governmental entitlements required to develop and use the property for residential home construction.

Each land acquisition proposal, which contains specific information relating to the market, property and community, is then subject to review and approval by our Management Executive Committee. The Management Executive Committee is comprised of our senior corporate officers and representatives from our Homebuilding operations.

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Land Supply. We acquire the entitled land and homesites we require for our homebuilding operations through a combination of purchases and option contracts. Under the option contracts, we purchase the right, but not the obligation, to buy homesites at predetermined prices on a predetermined takedown schedule anticipated to be commensurate with home starts. Homesite option contracts are non-recourse, thereby limiting our financial exposure to non-refundable deposits, which are typically less than 20% of the underlying purchase price. This enables us to control significant homesite positions with a minimal capital investment and reduces the risks associated with land ownership and development. We believe that our local reputation with land sellers or developers provides us a competitive advantage in acquiring homesites through option contracts. At September 30, 2003, we had 33,822 homesites under option or similar contracts, representing approximately 71% of our total homesite supply, and we had approximately \$75.1 million in deposits under those option contracts.

As of September 30, 2003, we had 47,618 homesites which were either owned or controlled under option contracts in our homesite inventory. This represents supply for approximately four years of operations, based on our current projections for home sales. The table below shows our homesite inventory by region and in total for the periods indicated:

	At December 31,			At September 30,
	2000(1)	2001	2002	2003
Florida	6,580	4,750	11,312	16,393
Mid-Atlantic	1,879	2,158	4,935	5,330
Texas	3,720	3,940	5,048	10,188
West	4,042	4,136	5,025	15,707
Total(2)	16,221	14,984	26,320	47,618

- (1) The homesite inventory as stated for 2000 reflects Newmark Homes' homesite position as of December 31 combined with Engle Homes' homesite position as of October 31.
- (2) Includes 7,062, 7,644 and 16,474 homesites under option contracts as of December 31, 2000, 2001 and 2002, respectively and 33,822 homesites under option contracts as of September 30, 2003.

As part of our land inventory management strategy, we occasionally exchange or sell a portion of the homesites and entitled land that we have purchased to third-party builders. Our division managers are constantly reviewing the competitive landscape and characteristics of each of our local markets. As we determine that certain types of homes, homes with certain anticipated prices or homes in certain communities are either selling quicker or at better margins, we will exchange or sell our homesites or land for other homesite or land options to capitalize on the market opportunities.

Purchasing

We use our purchasing power to achieve volume discounts and the best possible service from our vendors, thereby reducing costs, ensuring timely deliveries and reducing the risk of supply shortages due to allocations of materials. We have negotiated price arrangements, which we believe are favorable, to purchase lumber, sheetrock, appliances, heating and air conditioning, counter tops, bathroom fixtures, roofing and insulation products, concrete, bricks, floor coverings and other housing equipment and materials. Our purchase contracts are with high quality national and regional suppliers. There are no minimum purchase requirements for these arrangements, with flexibility reserved for each division to make independent purchasing decisions.

Design

To appeal to the tastes and preferences of local communities, we expend considerable effort in developing an appropriate design and marketing concept for each community, including determining the size, style and price range of the homes and, in certain projects, the layout of streets, individual homesites and overall community design. In addition, in certain markets, outside architects who are familiar with the

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local communities in which we build, assist us in preparing home designs and floor plans. The product line that we offer in a particular community depends upon many factors, including the housing generally available in the area, the needs of the particular market and our costs of homesites in the community. To improve the efficiency of our design process and make full use of our resources and expertise, we maintain a company-wide database of detailed information relating to the design and construction of our homes, including architectural plans previously or currently used in our other communities.

Design Centers

We maintain design centers in most of our markets as part of our marketing process and to assist our homebuyers in selecting options and upgrades which can result in additional revenues. The design centers heighten interest in our homes by allowing homebuyers to participate in the design process and introducing homebuyers to the various flooring, lighting, fixtures and hardware options available to them. In keeping with our regional approach, each region decides what type of design center is suitable for the local area. While the size and content of our design centers vary between markets, the focus of all of our design centers is on making the homebuyer's selection process less complicated and an enjoyable experience, while increasing our profitability.

Construction

Subcontractors perform substantially all of our construction work. Our construction superintendents monitor the construction of each home, coordinate the activities of subcontractors and suppliers, subject the work of subcontractors to quality and cost controls and monitor compliance with zoning and building codes. We typically retain subcontractors pursuant to a contract that obligates the subcontractor to complete construction at a fixed price in a workmanlike manner. In addition, under these contracts the subcontractor provides us with standard indemnifications and warranties. Typically, we work with the same subcontractors within each market, which provides us with a stable and reliable work force and better control over the costs and quality of the work performed. Although we compete with other homebuilders for qualified subcontractors, we have established long-standing relationships with many of our subcontractors and have not experienced any material difficulties in obtaining the services of desired subcontractors.

We typically complete the construction of a home within four to five months. Construction time, however, depends on weather, availability of labor, materials, supplies and other factors. We do not maintain significant inventories of construction materials, except for materials related to work in progress for homes under construction. Generally, the construction materials used in our operations are readily available from numerous sources. We have established price arrangements or contracts, which we believe are favorable, with suppliers of certain of our building materials, but we are not under specific purchasing requirements. In recent years, we have not experienced significant delays in construction due to shortages of materials.

We have, and will continue to establish, and maintain information systems and other practices and procedures that allow us to more effectively manage our subcontractors and the construction process. For example, we have implemented information systems that monitor homebuilding production, scheduling and budgeting. We believe that this program has and will continue to improve our efficiency and decrease our construction time.

Marketing and Sales

We build and market different types of homes to meet the needs of different homebuyers and the needs of different markets. We employ a variety of marketing techniques to attract potential homebuyers through numerous avenues, including Internet web sites for our various homebuilding brands and subsidiaries, advertising and other marketing programs. We advertise on television, in newspapers and other publications, through our own brochures and newsletters, on billboards and in brochures and newsletters

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produced and distributed by real estate and mortgage brokers. Some of our suppliers participate in our advertising and promotional materials, either through co-branding, cost-sharing or through rebates.

We typically conduct home sales activities from sales offices located in furnished model homes in each community. We use commissioned sales personnel who assist prospective buyers by providing them with floor plans, price information, tours of model homes and information on the available options and other custom features. We provide our sales personnel with extensive training, and we keep them updated as to the availability of financing, construction schedules and marketing and advertising plans to facilitate their marketing and sales activities. We supplement our in-house training program with training by outside sales and marketing consultants.

We market and sell homes through our own commissioned sales personnel and in cooperation with independent real estate brokers. Because 60% of our sales (based on homes delivered) originate from independent real estate brokers, we sponsor a variety of programs and events, including breakfasts, contests and other events to provide the brokers with a level of familiarity with our communities, homes and financing options necessary to successfully market our homes. We also offer other incentives to brokers to actively market our homes.

Sales of our homes generally are made pursuant to a standard sales contract that is tailored to the requirements of each jurisdiction. Generally, our sales contracts require a deposit of a fixed amount (typically up to \$5,000) on our less expensive homes or as a percentage of the sales price (typically 5% to 10%) on our more expensive customized homes. The contract includes a financing contingency which permits the customer to cancel in the event mortgage financing at prevailing interest rates cannot be obtained within a specified period, typically 30 days from the signing. The contract may include other contingencies, such as the prior sale of a buyer's existing home. We estimate that the average period between the execution of a sales contract for a home and closing is approximately four to six months for presold homes.

Customer Service and Quality Control

Our operating divisions are responsible for both pre-delivery quality control inspections and responding to customers' post-delivery needs. We believe that the prompt, courteous response to homebuyers' needs reduces post-delivery repair costs, enhances our reputation for quality and service and ultimately leads to significant repeat and referral business. We conduct home orientations and pre-delivery inspections and interviews with homebuyers immediately before closing. In conjunction with these inspections, we create a list of unfinished construction items and address outstanding issues promptly.

An integral part of our customer service program includes post-delivery interviews. In most of our markets we contract independent third parties to conduct periodic post-delivery evaluations of the customer's satisfaction with their home, as well as the customer's experience with our sales personnel, construction department and title and mortgage services. Typically, approximately one year after we sell a home we arrange for follow-up interviews with the homeowner to determine the level of the homeowner's continued satisfaction. These interviews provide us with a direct link to the customer's perception of the entire buying experience as well as valuable feedback on the quality of the homes we deliver and the services we provide.

Warranty Program

For all homes we build, we provide our homebuyers with a one-year or two-year limited warranty of workmanship and materials, and an eight-year or ten-year limited warranty covering major structural defects. The extent of these warranties may differ in some or all of the states in which we operate. We recently obtained a homebuilder protective policy which covers warranty claims for structure and design defects related to homes sold by us during the policy period, subject to a retention amount. We have, and are continuing to implement, a warranty program in conjunction with our homebuilder protective policy insurance carrier that we believe will allow us to more effectively manage and resolve our warranty claims. We subcontract homebuilding work to subcontractors who provide us with an indemnity and a certificate

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of insurance before receiving payments for their work and, therefore, claims relating to workmanship and materials are the primary responsibility of our subcontractors. However, there is no assurance that we will be able to enforce these contractual indemnities. After we deliver a home, we process all warranty requests through our customer service departments located in each of our markets. In most instances, a customer service manager inspects the warranty request within 48 hours of receipt. If a warranty repair is necessary, we manage and supervise the repair to ensure that the appropriate subcontractor takes prompt and appropriate corrective action. Additionally, we have developed a pro-active response and remediation protocol to address any warranty claim that may result in mold damage. We generally have not had any material litigation or claims regarding warranties or latent defects with respect to construction of homes. Current claims and litigation are expected to be substantially covered by our reserves or insurance.

Financial Services

As part of our objective to provide homebuyers a seamless home purchasing experience, we have developed, and are expanding, our complementary financial services business. As part of this business, we provide mortgage financing and closing services and offer title, homeowners and other insurance products. Our mortgage financing operation derives most of its revenues from buyers of our homes, although it also offers its services to existing homeowners refinancing their mortgages. By comparison, our closing services and our insurance agency operations, are used by our homebuyers as well as a broad range of other clients purchasing or refinancing residential or commercial real estate.

Our mortgage business consists of providing our homebuyers and third party homebuyers with loan origination services, purchase financing and, to a lesser extent, mortgage refinancing. We are an approved seller/servicer of Federal National Mortgage Association, Federal Home Loan Mortgage Corporation, Federal Housing Administration, Veterans Association and U.S. Department of Housing and Urban Development loans. We sell substantially all of our loans and the related servicing rights to third-party investors. We conduct this business through our subsidiary, Preferred Home Mortgage Company. Preferred Home has its headquarters in Boca Raton, Florida and has offices in each of our markets.

For the nine months ended September 30, 2003, approximately 58% of our homebuyers utilized the services of our mortgage business. We believe we have an opportunity to expand this business, particularly in our recently-acquired markets. We originated approximately \$782.8 million aggregate principal amount of mortgage loans for the twelve months ended December 31, 2002. Our mortgage business generated pre-tax income of \$13.5 million for the twelve months ended December 31, 2002.

Through our title services business, we, as agent, obtain competitively-priced title insurance for, and provide closing services to, our homebuyers as well as outside third party homebuyers. We conduct this business through our subsidiary, Universal Land Title, Inc. and its subsidiaries. Universal operates as a traditional title agency with its headquarters in West Palm Beach, Florida and has 22 additional offices.

Universal Land Title works with national underwriters and lenders to facilitate client service and coordinate closing at its offices. It is equipped to handle e-commerce applications, e-mail closing packages, digital document delivery and web-based closings. The principal sources of revenues generated by our title insurance business are fees paid to Universal Land Title for title insurance obtained for our homebuyers and other third party residential purchasers.

For the nine months ended September 30, 2003, approximately 81% of our homebuyers used Universal Land Title or its affiliates for their title insurance agency and closing services. We continue to expand our title services business to markets not currently served by Universal Land Title. Our title services business generated pre-tax income of \$5.9 million for the year ended December 31, 2002. Third party homebuyers (or non-company customers) accounted for 87% of our title services business revenue for the year ended December 31, 2002.

Alliance Insurance and Information Services, LLC, owned by Universal Land Title, is a full service insurance agency serving all of our markets. Alliance markets homeowners, flood and auto insurance directly to homebuyers and others in all of our markets and also markets life insurance in Florida.

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Interested homebuyers obtain free quotes and have the necessary paperwork delivered directly to the closing table for added convenience. For the nine months ended September 30, 2003, 21% of our homebuyers used Alliance for their insurance needs.

Governmental Regulation

We must comply with state and local laws and regulations relating to, among other things, zoning, treatment of waste, land development, required construction materials, density requirements, building design and elevation of homes, in connection with the construction of our homes. These include laws requiring use of construction materials that reduce the need for energy-consuming heating and cooling systems. In addition, we and our subcontractors are subject to laws and regulations relating to employee health and safety. These laws and regulations are subject to frequent change and often increase construction costs. In some cases, there are laws that require that commitments to provide roads and other infrastructure be in place prior to the commencement of new construction. These laws and regulations are usually administered by individual counties and municipalities and may result in fees and assessments or building moratoriums. In addition, certain new development projects are subject to assessments for schools, parks, streets and highways and other public improvements, the costs of which can be substantial.

The residential homebuilding industry also is subject to a variety of local, state and federal statutes, ordinances, rules and regulations concerning the protection of health and the environment. Environmental laws and conditions may result in delays, may cause us to incur substantial compliance and other costs and can prohibit or severely restrict homebuilding activity in environmentally sensitive regions or areas. In recent years, several cities and counties in which we have developments have submitted to voters slow growth or no growth initiatives and other ballot measures which could impact the affordability and availability of homes and land within those localities.

In order to make it possible for purchasers of some of our homes to obtain FHA-insured or VA-guaranteed mortgages, we must construct those homes in compliance with regulations promulgated by those agencies.

Our title insurance agency subsidiaries must comply with applicable insurance laws and regulations. Our mortgage financing subsidiaries must comply with applicable real estate lending laws and regulations. The mortgage financing and title insurance subsidiaries are licensed in the states in which they do business and must comply with laws and regulations in those states regarding mortgage financing and title insurance companies. These laws and regulations include provisions regarding capitalization, operating procedures, investments, forms of policies and premiums.

Competition and Market Forces

The development and sale of residential properties is a highly competitive business. We compete in each of our markets with numerous national, regional and local builders on the basis of a number of interrelated factors including location, price, reputation, amenities, design, quality and financing. Builders of new homes compete for homebuyers, as well as for desirable properties, raw materials and reliable, skilled subcontractors. We also compete with resales of existing homes, available rental housing and, to a lesser extent, resales of condominiums. We believe we generally compare favorably to other builders in the markets in which we operate, due primarily to:

our experience within our geographic markets;

the ability of our local managers to identify and quickly respond to local market conditions; and

our reputation for service and quality.

The housing industry is cyclical and is affected by consumer confidence levels and prevailing economic conditions, including interest rate levels. A variety of other factors affect the housing industry and demand for new homes, including the availability of labor and materials and increases in the costs thereof, changes in costs associated with home ownership such as increases in property taxes, energy costs,

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changes in consumer preferences, demographic trends and the availability of and changes in mortgage financing programs.

We compete with other mortgage lenders, including national, regional and local mortgage bankers, savings and loan associations and other financial institutions, in the origination, sale and servicing of mortgage loans. Principal competitive factors include interest rates and other features of mortgage loan products available to the consumer. We compete with other insurance agencies, including national, regional and local insurance agencies, in the sale of title insurance, homeowner insurance and related insurance services. Principal competitive factors include cost and other features of insurance products available to the consumer.

Employees

At September 30, 2003, we employed 1,637 people. None of our employees are covered by collective bargaining agreements. We believe our relations with our employees are good.

Properties

We lease our executive offices located at 4000 Hollywood Blvd., Suite 500 N, Hollywood, Florida 33021. We own a 19,000 square foot facility in Sugar Land, Texas, which houses our Houston homebuilding operations and a design center, which allows a prospective homebuyer to view samples of some of the products and features we offer in our homes in Houston. We lease an aggregate of approximately 150,616 square feet of additional office space in our markets for our homebuilding and financial services operations and our corporate offices. We believe our existing facilities are adequate for our current and planned levels of operations.

Legal Proceedings

We are involved in various claims and legal actions arising in the ordinary course of business. We do not believe that the ultimate resolution of these matters will have a material adverse effect on our financial condition or results of operations.

Table of Contents**BOARD OF DIRECTORS**

The following table sets forth the names, ages and positions of each of our directors. Each of the directors' term of office will expire at the next annual meeting of our stockholders.

Name	Age	Position
Constantine Stengos	66	Chairman of the Board
Antonio B. Mon	58	Executive Vice Chairman, Chief Executive Officer, President and Director
Yannis Delikanakis	36	Executive Vice President and Director
Andreas Stengos	41	Director
George Stengos	36	Director
Larry D. Horner	69	Director
William A. Hasler	61	Director
Michael J. Poulos	72	Director
Lonnie M. Fedrick	59	Director

Below is a short biography of the business experience of each of our directors.

Constantine Stengos has been the Chairman of the Board of our company since December 15, 1999. From November 1999 through October 2003, Mr. Stengos served as a director and President of Technical Olympic. Mr. Stengos has also served as a director of Technical Olympic (UK) Ltd., since November 1999. Mr. Stengos formed Technical Olympic S.A. in 1965 and has continued to serve as its President and Managing Director. Mr. Stengos owns more than 5% of the outstanding equity of Technical Olympic S.A., which is publicly traded on the Athens Stock Exchange. Technical Olympic (UK) Ltd. and Technical Olympic S.A. are all our affiliates.

Antonio B. Mon became a director of our company, and our Executive Vice Chairman, Chief Executive Officer, and President, on June 25, 2002. From October 2001 to June 2002, Mr. Mon served as the Chief Executive Officer of Technical Olympic. From May 2001 to October 2001, Mr. Mon was a consultant to Technical Olympic. From 1997 to 2001, Mr. Mon was the Chairman of Maywood Investment Company, LLC, a private firm engaged in private equity investments and general consulting. In 1991, Mr. Mon co-founded Pacific Greystone Corporation, a west coast homebuilder that merged with Lennar Corporation in 1997, and served as its Vice Chairman from 1991 to 1997. Prior to 1991, Mr. Mon worked in various positions for The Ryland Group, Inc. (a national homebuilder), M.J. Brock Corporation (a California homebuilder) and Cigna Corporation (a financial services corporation).

Yannis Delikanakis has been a director of our company since 1999 and became our Executive Vice President on January 1, 2003. From 1999 through October 2003, Mr. Delikanakis served as a director and Vice President of Technical Olympic. Mr. Delikanakis has been the General Manager - Real Estate of Technical Olympic S.A. since 1999. Mr. Delikanakis was a director and the manager of the Real Estate Development and Project Management Departments of Lambert Smith Hampton S.A. from 1994 to 1999.

Andreas Stengos has been a director of our company since 1999 and has been a director of Technical Olympic (UK) Ltd. since 1997. From 1999 through October 2003, Mr. Stengos served as a director and Treasurer of Technical Olympic. Mr. Stengos has also been a director of Technical Olympic S.A. since 1989, and has served as its General Manager since 1995.

George Stengos has been a director of our company since 1999 and has been a director of Technical Olympic (UK) Ltd. since 1997. From November 1999 through October 2003, Mr. Stengos served as a director of Technical Olympic. From 2001 to December 2002, Mr. Stengos served as President and Chairman of the Board of Mochlos S.A., a subsidiary of Technical Olympic S.A. which is publicly traded on the Athens Stock Exchange. From 1993 to 2000, Mr. Stengos was the Executive Vice President of Mochlos S.A.

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Larry D. Horner has been a director of our company since 1997. Mr. Horner served as Chairman of Pacific USA Holdings Corp. from 1994 to 2001 and was Chairman of the Board of Asia Pacific Wire & Cable Corporation Limited, a manufacturer of copper wire and cable and fiber optic wire products, with operations in Southeast Asia, which was publicly traded on the New York Stock Exchange until 2001. He is also a director of ConocoPhillips, Atlantis Plastics Corp., UT Starcom, Inc., Novitron International, Inc. and New River Pharmaceuticals, Inc. Mr. Horner was formerly associated with KPMG LLP, a professional services firm, for 35 years, retiring as Chairman and Chief Executive Officer of both the U.S. and International firms in 1991. He is a certified public accountant.

William A. Hasler has been a director of our company since 1998. Mr. Hasler has served as Vice Chair and Co-Chief Executive Officer of Apton Corporation, a biotechnology products company, since July 1998. From August 1991 to July 1998, Mr. Hasler served as Dean of the Haas School of Business at the University of California at Berkeley. Prior to that, he was both Vice Chairman and a director of KPMG LLP, a professional services firm. Mr. Hasler also serves on the boards of Mission West, Elevon, DiTech Communications, Schwab Funds and DMC Stratex, and is Chairman of the Board of Solectron Corp. Mr. Hasler is a trustee of Pomona College. He is a certified public accountant.

Michael J. Poulos has been a director of our company since 2000. Mr. Poulos also serves as an advisory director of Greystone Capital Partners I, LP and a trustee of Century Shares Trust. Mr. Poulos had been Chairman, President and Chief Executive Officer of Western National Corporation from 1993 until 1998 when he retired. Mr. Poulos worked for American General Corporation, from 1970 to 1993, and served as its Vice Chairman from 1991 to 1993.

Lonnie M. Fedrick has been a director of our company since 1997 and served as our President and Chief Executive Officer from 1997 until June 25, 2002. Mr. Fedrick was President and Chief Executive Officer of Newmark Home Corporation since 1994 and was its Executive Vice President from 1984 to 1994.

Board Committees

We have a strong commitment to establishing and maintaining corporate governance standards of excellence. As part of this commitment, our board of directors has four standing committees: audit committee, compensation and benefits committee, independent directors committee and board executive committee. Three of these committees, the audit, compensation and benefits and independent directors committees are composed entirely of outside directors. We define outside directors as directors that are neither members of management, nor affiliated with, or employed by, our principal stockholder. On a regular basis, we consult with Greenberg Traurig, P.A. for legal counsel on corporate governance matters and issues relating to the fiduciary duties of our board and committee members.

Audit Committee. Our audit committee generally has responsibility for appointing, overseeing and determining the compensation of our independent auditors, reviewing the plan and scope of the accountants' audit, reviewing our audit and control functions, approving all non-audit services provided by our independent auditors and reporting to our full board of directors regarding all of the foregoing. Our audit committee meets with the auditors and our management in connection with its review and approval of (i) the unaudited financials for inclusion in our quarterly reports and (ii) the annual audited financial statements for inclusion in our Annual Report on Form 10-K. Additionally, our audit committee provides our board of directors with such additional information and materials as it may deem necessary to make our board of directors aware of significant financial matters that require its attention. Our audit committee's goals and responsibilities are set forth in an audit committee charter. Our audit committee consists of Messrs. Horner, Hasler and Poulos.

Compensation and Benefits Committee. Our compensation and benefits committee reviews and approves all forms of compensation and benefits, including salary, bonus and stock compensation, provided to our chief executive officer and other executive officers of our company. In addition, the compensation and benefits committee reviews and approves all forms of compensation provided to

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our directors and is responsible for administering our Annual and Long-Term Incentive Plan. Our compensation and benefits committee consists of Messrs. Horner, Hasler and Poulos.

Independent Directors Committee. Our independent directors committee generally has responsibility for considering and acting on any proposed transaction that would be considered a related party transaction, as well as any other matters that require the review and/or approval of our outside directors. In addition, our independent directors committee solicits, considers and nominates candidates to serve on our board of directors. Our independent directors committee consists of Messrs. Horner, Hasler and Poulos.

Board Executive Committee. Our board executive committee has authority to consider and approve transactions, acquisitions, investments, operational matters, corporate management, financing and other actions by us or our subsidiaries for transactions not exceeding \$20.0 million, and land acquisitions not exceeding \$35.0 million, and makes reports to the full board of directors. Our board executive committee consists of Messrs. Horner, Delikanakis, Mon and George Stengos. Tommy McAden, our chief financial officer, serves as the management representative to the board executive committee.

Family Relationships

Constantine Stengos is the father of both Andreas Stengos and George Stengos. Yannis Delikanakis is the son-in-law of Constantine Stengos and the brother-in-law of Andreas Stengos and George Stengos. We have no other familial relationships among the executive officers and other directors.

Compensation Committee Interlocks and Insider Participation

Messrs. Horner, Hasler and Poulos comprised the Special Benefits Committee in 2002. None of these persons served as an officer or employee of ours or any of our subsidiaries during fiscal year 2002. There were no material transactions between us and any of the members of the Special Benefits Committee during fiscal year 2002.

Messrs. Horner, Hasler, Delikanakis, Andreas Stengos and George Stengos comprised the Compensation Committee in 2002. Other than Messrs. Delikanakis and Andreas Stengos, who each served as non-employee officers of certain of our subsidiaries during fiscal year 2002, none of the other members of the Compensation Committee served as an officer or employee of ours or any of our subsidiaries. During 2002, we and our subsidiary TOUSA Homes, Inc. made payments of \$191.6 million to Technical Olympic S.A. pursuant to the Purchasing Agreements described under Certain Relationships and Related Transactions. Mr. Andreas Stengos serves as a director and executive officer of Technical Olympic S.A., and Mr. Delikanakis served as an executive officer of Technical Olympic S.A. during fiscal year 2002.

On February 3, 2003, the Special Benefits Committee and the Compensation Committee were merged to form the Compensation and Benefits Committee on which only independent directors may serve.

Compensation of Directors

For the fiscal year 2002, our independent directors, Messrs. Hasler, Horner and Poulos, received an annual fee of \$15,000 and \$2,000 per Board meeting attended and each was reimbursed for reasonable out-of-pocket expenses incurred for attendance at meetings. For 2003, each outside director, other than the senior outside director, will receive an annual cash fee of \$40,000, reimbursement of meeting expenses and an annual equity award of either non-qualified stock options or restricted stock valued at \$40,000. Under our policy, the designated senior outside director shall receive an annual cash retainer of \$80,000, reimbursement of meeting expenses and an annual equity award valued at \$80,000. For 2003, Mr. Horner was designated our senior outside director. Directors who also served as officers of ours did not receive any additional compensation for their services as directors during 2002.

Effective January 1, 2003, we entered into a consulting agreement with Mr. Fedrick with an initial term of three years. Under the terms of the consulting agreement, Mr. Fedrick will receive an annual fee

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of \$400,000. Upon recommendation of our chief executive officer and approval of our board of directors or a designated committee, Mr. Fedrick may receive a bonus or other compensation in his capacity as a consultant. During the term of the agreement, in addition to his service as a member of the board of directors, Mr. Fedrick will: (a) provide land review, acquisition, and development services for our Houston operations, (b) identify and acquire land in the greater Houston area, (c) perform other assignments requested by the Chairman of the board of directors or our chief executive officer from time to time, (d) transition his network of contacts and local knowledge to our management, and (e) provide other general business advisory services. Mr. Fedrick will devote at least 20% on average of his working time and energy to our business during the initial term. The consulting agreement contains non-compete and non-interference provisions and expires on January 1, 2006.

Table of Contents**MANAGEMENT**

Our executive officers, their ages and positions are as follows:

Name	Age	Position
Antonio B. Mon	58	Executive Vice Chairman, Chief Executive Officer, President and Director
Tommy L. McAden	41	Vice President Finance and Administration, Chief Financial Officer and Treasurer
Yannis Delikanakis	36	Executive Vice President and Director
Patricia M. Petersen	43	Vice President and General Counsel
Randy L. Kotler	38	Vice President and Chief Accounting Officer
Harry Engelstein	68	Executive Vice President TOUSA Homes
J. Eric Rome	44	Executive Vice President TOUSA Homes
Mark R. Upton	46	Executive Vice President TOUSA Homes

Below is a summary of the business experience of each of our executive officers, other than Mr. Mon and Mr. Delikanakis whose biographies appear under the section Board of Directors.

Tommy L. McAden became our Vice President of Finance and Administration, Chief Financial Officer and Treasurer on June 25, 2002. Mr. McAden served as a director, Vice President and Chief Financial Officer of Technical Olympic from January 2000 to June 25, 2002. From 1994 to December 1999, Mr. McAden was Chief Financial Officer of Pacific Realty Group, Inc., which was our former 80% stockholder.

Patricia M. Petersen became our Vice President and General Counsel on September 1, 2002. Before joining our company, Ms. Petersen served as Assistant General Counsel of Corning Incorporated from December 2000 to August 2002. From September 1992 to November 2000, Ms. Petersen served as Managing Partner of the Nestor Nestor Kingston Petersen law firm in Bucharest, Romania, and from 1990 to August 1992 as Associate Counsel with the Hillis Clark Martin & Peterson law firm in Seattle, Washington.

Randy L. Kotler became our Vice President and Chief Accounting Officer on June 25, 2002. Prior to joining our company, Mr. Kotler spent 13 years in public accounting, including the last five with Ernst & Young LLP in its Real Estate Group. Mr. Kotler is a certified public accountant.

Harry Engelstein became an Executive Vice President of TOUSA Homes, Inc. on February 3, 2003. Mr. Engelstein began his career in homebuilding in Montreal, Canada, in 1960 as a contractor. In 1979, he moved to Florida to help form Engle Homes. In 1992, Engle Homes went public and Mr. Engelstein, as Executive Vice President, managed the South Florida Division.

J. Eric Rome became an Executive Vice President of TOUSA Homes, Inc. on February 3, 2003. Mr. Rome joined Newmark Homes in 1983 and has held various management positions, including serving as Chief Operating Officer of Newmark Homes and as President of Newmark Homes Texas and Tennessee Divisions.

Mark R. Upton became an Executive Vice President of TOUSA Homes, Inc. on February 3, 2003. Mr. Upton served as President of Engle Homes/Arizona, Inc. since 1997 and has spent 25 years in the homebuilding business. Prior to joining Engle Homes, Mr. Upton was Executive Vice President of UDC Homes, and had regional responsibility for various operating divisions. Before UDC, he held various management positions with Ryan Homes.

Table of Contents**EXECUTIVE COMPENSATION**

The following table presents certain summary information concerning compensation earned for services rendered in all capacities by each of the two individuals who served as Chief Executive Officer as well as our other four most highly compensated executive officers (the Named Executive Officers) whose total annual salary and bonus exceeded \$100,000 during the fiscal year ended December 31, 2002.

Name and Principal Position	Year	Annual Compensation			Long Term Compensation Awards	All Other Compensation(\$)
		Salary(\$)	Bonus(\$)	Other Annual Compensation(\$)	Securities Under-Lying Options(#)	
Antonio B. Mon	2002	828,333	2,394,700	61,644(2)	1,756,364	111,636(3)
Chief Executive Officer,	2001			*		
President and Director(1)	2000			*		
Tommy L. McAden	2002	395,833	550,000	*	439,091	
Vice President Finance and	2001			*		
Administration, Chief Financial	2000			*		
Officer and Treasurer(1)						
Harry Engelstein	2002	415,000	969,064	*		
Executive Vice President	2001	385,000	902,948	*		
TOUSA Homes	2000	315,000	501,500	*		
J. Eric Rome	2002	408,846	800,000	*		
Executive Vice President	2001	350,000	479,640	*		
TOUSA Homes	2000	300,000	467,390	*		
Mark R. Upton	2002	239,850	696,927	*		
Executive Vice President	2001	234,000	791,981	*		
TOUSA Homes	2000	225,000	696,927	*		
Lonnie M. Fedrick	2002	564,808	696,291	*		
Former Chief Executive Officer,	2001	550,000	1,450,685	*		
President and Director(4)	2000	525,000	1,497,702	*		

* Value of perquisites and other personal benefits does not exceed the lesser of \$50,000 or 10% of the total of annual salary and bonus reported for the Named Executive Officer.

- (1) The amounts represented for 2002 include the full year of compensation received by Messrs. Mon and McAden. Prior to June 25, 2002, compensation to Messrs. Mon and McAden was received from Technical Olympic.
- (2) This amount represents an automobile allowance and a lease of a home, including tax gross-up payments.
- (3) The amount represents premiums paid for life insurance policies.
- (4) Mr. Fedrick served as the Chief Executive Officer from January 1, 2002 to June 25, 2002. Mr. Mon has been serving as our Chief Executive Officer since June 25, 2002.

Table of Contents**Stock Option Grants and Exercise**

The following table provides certain information concerning individual grants of stock options under our Annual and Long-Term Incentive Plan made during the year ended December 31, 2002 to the Named Executive Officers who are listed below. None of the other Named Executive Officers received any option grants during the year ended December 31, 2002.

Option Grants in Last Fiscal Year

Name	Number of Securities Underlying Options Granted(#)	Percent of Total Options Granted to Employees in Fiscal Year	Exercise or Base Price (\$/Sh)	Expiration Date	Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term	
					5%(\$)	10%(\$)
Antonio B. Mon	702,541		17.17	12/31/2012	4,882,660	14,921,971
	351,274		18.89	12/31/2012	1,837,163	6,856,868
	351,274		20.78	12/31/2012	1,173,255	6,192,961
	351,275		22.86	12/31/2012	442,607	5,462,326
	1,756,364	80%				
Tommy L. McAden	175,637		17.17	12/31/2012	1,220,677	3,730,530
	87,818		18.89	12/31/2012	459,288	1,714,207
	87,818		20.78	12/31/2012	292,434	1,546,475
	87,818		22.86	12/31/2012	110,651	1,365,570
	439,091	20%				

The following table provides information regarding the options exercised by the Named Executive Officers listed below during fiscal 2002 and the value of options outstanding for such individuals at December 31, 2002. None of the other Named Executive Officers owned any options at December 31, 2002.

Aggregated Option Exercises in Last Fiscal Year and Fiscal Year-End Option Values

Name	Shares Acquired on Exercise(#)	Value Realized(\$)	Number of Securities Underlying Unexercised Options at Fiscal Year-End(#)		Value of Unexercised In-The-Money Options at Fiscal Year-End\$(1)	
			Exercisable	Unexercisable	Exercisable	Unexercisable
Antonio B. Mon			228,320	1,528,044		
Tommy L. McAden			57,082	382,009		

(1) Based on the closing price of our common stock on December 31, 2002 of \$14.81.

Employment Agreements

Antonio B. Mon. Upon the consummation of the merger on June 25, 2002, Antonio B. Mon became our Chief Executive Officer, President and Executive Vice-Chairman, as well as one of our directors. Pursuant to the terms of the employment agreement between Mr. Mon and us, which became effective on the date of the merger and expires on December 31, 2006, Mr. Mon will receive a minimum base salary of \$800,000 for the first year with an increase of 10% per year thereafter until the agreement expires or is terminated. Mr. Mon will be eligible to receive an annual bonus and equity awards under our Annual and Long-Term Incentive Plan, and Mr. Mon was granted 1,756,364 options to purchase

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shares of our common stock. In the event of termination by us without cause and not as a result of his disability or death, or in the event Mr. Mon terminates for good reason or due to a change in control, we will pay Mr. Mon the greater of (a) three times the sum of his base salary, his highest annual cash bonus and the value of his fringe benefits or (b) the aggregate amount of his base salary, his annual cash bonuses and

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the value of the fringe benefits that would be payable for the remainder of the agreement term. He will also receive continued health plan coverage until age 65 or until he becomes covered under another plan. In addition, if payments are deemed to constitute excess parachute payments, and Mr. Mon becomes liable for any tax penalties imposed thereon, we will make a cash payment to him in an amount equal to the tax penalties. The agreement contains non-compete provisions in the event of termination of employment. On July 15, 2003, we amended the employment agreement between Mr. Mon and us. The amendment extended the term of the employment agreement to December 31, 2008. In addition, the amendment provides that Mr. Mon will be eligible to receive equity incentive compensation for each of 2007 and 2008 in an amount per year equal to one percent (1%) of our then outstanding shares on a fully-diluted basis. The form of the equity incentive compensation will be mutually agreed between Mr. Mon and us within 180 days of July 15, 2003. We currently expect that the equity incentive compensation will take the form of options to purchase shares of our common stock. The exercise price for the shares will be \$30.43 for the 2007 grant and \$33.47 for the 2008 grant. We currently expect the grants to vest one year from the grant date and expire ten years from the date of the amendment.

Tommy L. McAden. Upon the consummation of the merger on June 25, 2002, Tommy L. McAden became our Vice President of Finance and Administration, Chief Financial Officer and Treasurer. Pursuant to the terms of the employment agreement between Mr. McAden and us, which became effective on the date of the merger and expires on June 25, 2005, Mr. McAden will receive a minimum base salary of \$380,000 and may receive annual salary increases. Mr. McAden will receive an annual bonus and equity awards under our Annual and Long-Term Incentive Plan with respect to each of the years 2002, 2003 and 2004, and Mr. McAden was granted 439,091 options to purchase shares of our common stock. In the event of termination by us without cause, or by Mr. McAden for good reason, we will pay Mr. McAden a termination payment in the amount of the sum of his base salary, annual bonus and the value of any benefits and perquisites that would have been payable or provided to Mr. McAden during the remainder of the agreement term, and accrued compensation. In the event of termination of Mr. McAden's employment due to disability, Mr. McAden will receive accrued base salary and bonus for the year, the economic value of any accrued but unused vacation time and unreimbursed expenses. In the event of a change in control and Mr. McAden's termination of the agreement on this basis, he will receive the greater of (a) the termination payment due above or (b) two times the sum of his salary and annual bonus, plus the value of any benefits and perquisites that would have been provided during the remainder of the agreement term and accrued compensation. In addition, if payments are deemed to constitute excess parachute payments, and Mr. McAden becomes liable for any tax penalties imposed thereon, we will make a cash payment to him in an amount equal to the tax penalties. The agreement contains non-compete provisions in the event of termination of employment.

Yannis Delikanakis. On January 1, 2003, Yannis Delikanakis became our Executive Vice President, pursuant to the terms of an employment agreement between Mr. Delikanakis and us, which became effective on January 1, 2003 and expires on December 31, 2008, Mr. Delikanakis will receive a minimum base salary of \$75,000 per year and was granted 900,000 options to purchase shares of our common stock. Mr. Delikanakis will not receive any bonus or other compensation unless approved by our board of directors and our independent directors committee. In the event of any termination, Mr. Delikanakis will receive only unreimbursed business expenses incurred by Mr. Delikanakis. In addition, if payments are deemed to constitute excess parachute payments, and Mr. Delikanakis becomes liable for any tax penalties imposed thereon, we will make a cash payment to him in an amount equal to the tax penalties. The employment agreement contains non-compete provisions in the event of termination of employment.

Harry Engelstein. Effective November 12, 2000, Engle Homes, Inc. and Mr. Engelstein entered into an employment agreement with a term ending on December 31, 2003. Pursuant to that agreement, Mr. Engelstein would serve as Executive Vice President and Chief Construction Officer of Engle Homes, Inc. The continuing relationship between us and Mr. Engelstein in his role as an Executive Vice President of our homebuilding operations are on terms substantially similar to those set forth in the employment agreement. In 2002, Mr. Engelstein received a base salary of \$415,000 and received an annual bonus based on a specific formula set forth in the agreement. If Mr. Engelstein's employment is terminated due to

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disability or death, Mr. Engelstein will be entitled to receive salary, together with any accrued, vested or earned obligations, through the termination date. If Mr. Engelstein is terminated for cause, he will be entitled to receive his highest base salary through the date of termination. If Mr. Engelstein's employment is terminated by the company other than for cause, disability or death, or by Mr. Engelstein for good reason, Mr. Engelstein will be entitled to receive salary, bonus, all accrued obligations, deferred compensation and insurance and related benefits as would have been payable for the remainder of the employment term. In the event of a change in control and a resulting termination of the agreement by Mr. Engelstein for good reason or by us for any reason other than for cause, death or disability, he will receive a lump sum cash payment of two times the aggregate of his salary and recent bonus, plus certain other accrued and deferred compensation.

J. Eric Rome. Effective January 1, 2003, Mr. Rome became an Executive Vice President of our homebuilding operations pursuant to an employment agreement with a term ending on December 31, 2005. Pursuant to the agreement, Mr. Rome's base salary is \$420,000. If Mr. Rome's employment is terminated for cause, Mr. Rome will be entitled to receive accrued salary and any accrued obligations. If Mr. Rome's employment is terminated due to disability or death, Mr. Rome will be entitled to receive accrued salary and a pro-rated bonus. If Mr. Rome's employment is terminated by us for any other reason, or if Mr. Rome terminates for good reason, Mr. Rome will be entitled to receive salary, bonus, all accrued obligations, deferred compensation and insurance and related benefits as would have been payable for the remainder of the employment term. The employment agreement contains non-compete provisions in the event of Mr. Rome's termination of employment.

Mark R. Upton. Effective November 12, 2000, Engle Homes, Inc. and Mr. Upton entered into an employment agreement with a term ending on December 31, 2003. Pursuant to that agreement, Mr. Upton would serve as President of the Engle Homes Arizona homebuilding operations. On April 1, 2003, the agreement was amended to (i) reflect his new responsibilities as an Executive Vice President of our homebuilding operations, (ii) extend the term of the agreement to December 31, 2004 and (iii) increase his base salary to \$420,000. In 2002, Mr. Upton received a base salary of \$239,850 and received quarterly bonuses based on a specific formula set forth in his agreement. If Mr. Upton's employment is terminated for cause, incapacity or death, Mr. Upton will be entitled to receive accrued salary and any accrued obligations. If Mr. Upton's employment is terminated for any other reason, or if Mr. Upton terminates for good reason, Mr. Upton will be entitled to receive salary, accrued obligations, a portion of the quarterly bonus and deferred compensation as would have been payable for the remainder of the employment term. In the event of a change in control and a resulting termination of the agreement by Mr. Upton for good reason or by us for any reason other than for cause, incapacity or death, he will receive a lump sum cash payment of two times the aggregate of his salary and recent bonus, plus certain other accrued and deferred compensation. The employment agreement contains non-compete provisions in the event of Mr. Upton's termination of employment.

Table of Contents**SECURITY OWNERSHIP**

The following table sets forth certain information as of October 29, 2003 regarding beneficial ownership of our common stock by the selling stockholder and by each of the following:

each person (or group of affiliated persons) whom we know to beneficially own more than 5% of the outstanding shares of our common stock;

each of our directors and our Named Executive Officers; and

all of our executive officers and directors as a group.

The percentage of beneficial ownership of shares owned after the offering is based on 29,889,036 shares of our common stock, after giving effect to the issuance of 2,000,000 shares of our common stock in this offering.

Name and Address of Beneficial Owner	Number of Shares Owned Before Offering(1)	Number of Shares to be Sold	Number of Shares Owned After Offering(1)	Percentage of Shares Owned After Offering
Technical Olympic S.A.(2) 20 Solomon Street Ana Kalamaki Athens, Greece 17456	25,278,787(3)	2,500,000	22,778,787	76.21%
Constantine Stengos	25,000		25,000	*
Antonio B. Mon	579,594(4)		579,594(4)	1.94%
Yannis Delikanakis	297,000(5)		297,000(5)	*
Andreas Stengos				*
George Stengos				*
Larry D. Horner	5,125		5,125	*
William A. Hasler	5,263(6)		5,263(6)	*
Michael J. Poulos	2,562		2,562	*
Lonnie M. Fedrick	45,462		45,462	*
Tommy L. McAden	144,900(7)		144,900(7)	*
Harry Engelstein				*
J. Eric Rome	9,000		9,000	*
Mark R. Upton				*
All directors and executive officers as a group (15 persons)	1,113,906(8)		1,113,906(8)	3.73%

* Less than one percent.

Except as otherwise indicated, the address of each person named in this table is c/o Technical Olympic USA, Inc., 4000 Hollywood Boulevard, Suite 500 North, Hollywood, Florida 33021.

- (1) The amounts and percentage of common stock beneficially owned are reported on the basis of regulations of the Commission. Under the rules of the Commission, a person is deemed to be a beneficial owner of a security if that person has or shares voting power, which includes the power to vote or direct the voting of the security, or investment power, which includes the power to dispose of or direct the disposition of the security. Except as indicated by footnote, and subject to community property laws where applicable, the persons named in the table below have sole voting and investment power with respect to all shares of common stock shown as beneficially owned by them. In addition, in determining the number and percentage of shares beneficially owned by each person, shares issuable pursuant to options exercisable within 60 days after October 29, 2003 are deemed outstanding for purposes of determining the total number of shares outstanding for such person but are not deemed outstanding for such purpose for all other shareholders. Under these rules, more than one person may be deemed a beneficial owner of the same securities, and a person may be deemed a beneficial owner of securities as to which he has no economic interest.

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- (2) Constantine Stengos owns more than 5% of the outstanding stock of Technical Olympic S.A. Technical Olympic S.A. owns 90.64% of our common stock and will own 76.21% of our common stock after the offering (73.95% if the over-allotment is exercised in full). Any material relationships between us and Technical Olympic S.A. are described in Certain Relationships and Related Transactions.
- (3) This amount reflects the sale of an aggregate of 300,000 shares of our common stock which were sold by Technical Olympic pursuant to Rule 144 of the Securities Act from May 27, 2003 to October 1, 2003. As a result of the restructuring transaction, the shares of our common stock owned by Technical Olympic were transferred to Technical Olympic S.A. effective as of October 30, 2003.
- (4) Consists solely of shares issuable upon exercise of stock options that have already vested or will vest within 60 days.
- (5) Consists solely of shares issuable upon exercise of stock options that have already vested or will vest within 60 days.
- (6) Consists solely of shares issuable upon exercise of stock options that have already vested or will vest within 60 days.
- (7) Consists solely of shares issuable upon exercise of stock options that have already vested or will vest within 60 days.
- (8) Includes 1,026,757 shares issuable upon exercise of stock options that have already vested or will vest within 60 days.

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CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Restructuring Transaction

In a restructuring transaction, all of the shares of Technical Olympic, our prior principal stockholder, were sold by Technical Olympic (UK) Ltd. to Technical Olympic S.A. Technical Olympic was then merged with and into TOI, LLC, a newly formed wholly-owned subsidiary of ours. As part of the merger, Technical Olympic S.A. acquired the shares of our common stock. Prior to the merger, Technical Olympic was a wholly-owned subsidiary of Technical Olympic (UK) Ltd., which is a wholly-owned subsidiary of Technical Olympic S.A. The restructuring was accomplished to eliminate global tax inefficiencies resulting from a double holding company structure.

Management Services Agreement

Pursuant to a Management Services Agreement between us and Technical Olympic (successor to Techolym L.P.), dated June 1, 2000, Technical Olympic provided us with certain advisory, administrative and other services. We made payments totaling \$1.5 million, \$1.9 million and \$1.4 million for the years ended December 31, 2000, 2001 and 2002, respectively, related to this agreement. On June 13, 2003, we entered into an Amended and Restated Management Services Agreement with Technical Olympic. The agreement was effective as of January 1, 2003 and expires on December 31, 2007. Pursuant to the amended agreement, Technical Olympic provided consultation with, and assistance to, our board of directors and management in connection with issues involving our business, as well as other services requested from time to time by our board of directors. In consideration for providing such services, we agreed to pay Technical Olympic an annual management fee of \$500,000 and, to the extent our net income for any fiscal year meets established targets, additional annual incentive fees, which may not exceed \$3.0 million. Pursuant to the agreement, we agreed to indemnify Technical Olympic for any liability incurred by it as a result of the performance of its duties other than any liability resulting from Technical Olympic's gross negligence or willful misconduct. We may terminate the agreement upon six months' prior written notice. In connection with the restructuring transaction, Technical Olympic assigned its obligations and rights under the Amended and Restated Management Services Agreement to Technical Olympic Services, Inc., a Delaware corporation wholly-owned by Technical Olympic S.A., effective as of October 29, 2003. Pursuant to the terms of our revolving credit facility, the aggregate amount of annual fees payable under the Amended and Restated Management Services Agreement may not exceed \$3.5 million.

Purchasing Agreements

In order to consolidate the purchasing function, we and our subsidiary TOUSA Homes, Inc. entered into non-exclusive purchasing agreements with Technical Olympic S.A. in November 2000. Under the purchasing agreements, Technical Olympic S.A. would purchase certain materials and supplies necessary for operations on our respective behalves and provide them to us at cost. No additional fees or other consideration are paid to Technical Olympic S.A. These agreements may be terminated upon 60 days' prior notice. Technical Olympic S.A. purchased an aggregate of \$70.5 million, \$342.6 million and \$191.6 million of materials and supplies on our behalf for the years ended December 31, 2000, 2001 and 2002, respectively. Constantine Stengos, our Chairman of the Board of Directors, is President and Managing Director of Technical Olympic S. A. Yannis Delikanakis, one of our directors, is General Manager - Real Estate of Technical Olympic S.A.

During the year ended December 31, 2002, one of our subsidiaries purchased approximately \$962,500 of homesites from Willow Park Green, Ltd. Michael Stevens, a former director, has an indirect limited partnership interest in such entity.

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Certain Land Bank Transactions

During 2001, Engle Homes, our predecessor-in-interest, sold certain undeveloped real estate tracts to, and entered into a number of agreements (including option contracts and construction contracts) with, Equity Group, a limited liability company controlled by Alec Englestein, Harry Englestein's brother. We made payments of \$11.9 million, \$36.0 million and \$7.0 million to this entity pursuant to these agreements during the twelve months ended December 31, 2001 and 2002 and the nine months ended September 30, 2003, respectively. As of June 30, 2003, the remaining homesites had been acquired and the agreements were terminated. On September 29, 2003, we entered into two additional option agreements with Equity Group. The two agreements provide that we purchase lots for a total aggregate sum of approximately \$16.1 million.

Merger Agreement

On June 25, 2002, we completed the merger with Engle Holdings. At the time of the merger, each issued and outstanding share of Engle Holdings common stock was exchanged for 1,724.08294 shares of Newmark Homes common stock and we changed our name to Technical Olympic USA, Inc. At the date of the merger, there were 9,500 shares of Engle Holdings common stock issued and outstanding, all of which were held by Technical Olympic. As a result of the merger, 16,378,787 shares of our common stock were issued to Technical Olympic. As a result of the restructuring transaction, the shares of our common stock owned by Technical Olympic were transferred to Technical Olympic S.A. effective as of October 30, 2003.

Tax Allocation Agreements

Pursuant to certain tax allocation agreements applicable to us and Engle Holdings, for tax periods ending on or after December 15, 1999 with respect to our company and on or after November 22, 2000 with respect to Engle Holdings, our and Engle Holdings' earnings may be included in the consolidated federal income tax returns filed by Technical Olympic. The amount of our and Engle Holdings' liability to (or entitlement to payment from) Technical Olympic equals the amount of taxes that each would respectively owe (or refund that each would receive) had we or Engle Holdings, as the case may be, prepared its federal tax returns on a stand-alone basis, and we and Engle Holdings have certain indemnification rights with respect to payments which we have made to Technical Olympic and any tax liabilities of Technical Olympic or its affiliated entities other than to us or Engle Holdings. With respect to the tax allocation agreements, we made payments totaling \$15.3 million, \$47.2 million and \$37.7 million for the years ended December 31, 2000, 2001 and 2002, respectively. The tax allocation agreement between Technical Olympic and Engle Homes was terminated after the merger. The tax allocation agreement between Technical Olympic and us was terminated as a result of the merger of Technical Olympic into one of our wholly-owned subsidiaries pursuant to the restructuring transaction.

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DESCRIPTION OF CAPITAL STOCK

We are authorized to issue up to 67,000,000 shares of common stock, \$0.01 par value per share and 3,000,000 million shares of preferred stock, \$0.01 par value per share. The following description summarizes information about our capital stock. You can obtain more information about our capital stock by reviewing our certificate of incorporation and bylaws, as well as the Delaware General Corporation Law.

Common Stock

Shares Outstanding; Listing. As of October 29, 2003, 27,889,036 shares of our common stock were issued and outstanding. Our common stock is listed on the Nasdaq National Market under the symbol TOUS.

Voting Rights. Holders of our common stock are entitled to one vote for each share held on all matters submitted to a vote of stockholders and do not have cumulative voting rights. Thus, holders of a majority of the shares of common stock entitled to vote in any election of directors may elect all of the directors standing for election. Our certificate of incorporation provides that our directors cannot be removed other than with the consent of holders of not less than two-thirds of the voting power of our common stock. Currently, Technical Olympic S.A. owns 90.64% of the voting power of our common stock and will own 76.21% following this offering (73.95% if the over-allotment is exercised in full).

Dividends. Each share of common stock is entitled to receive dividends if, as and when declared by the board of directors out of funds legally available for that purpose, subject to preferences that may apply to any preferred stock that we may issue in the future.

Liquidation Rights. In the event of our dissolution or liquidation, after satisfaction of all our debts and liabilities and distributions to the holders of any preferred stock that we may issue in the future, of amounts to which they are preferentially entitled, holders of our common stock are entitled to receive ratably all of our assets available in the distribution of assets to the stockholders.

Other Provisions. There are no conversion rights or preemptive or subscription rights to subscribe for any additional securities which we may issue. There are no redemption provisions or sinking fund provisions applicable to the common stock. All outstanding shares of common stock are fully paid and nonassessable.

The rights and preferences of holders of our common stock are subject to the rights of any series of preferred stock which we may issue in the future.

Preferred Stock

As of October 29, 2003, there were no shares of our preferred stock outstanding.

Our board of directors is authorized by our certificate of incorporation to provide for the issuance of shares of preferred stock, in one or more series, to establish or modify the number of shares to be included in each series, to fix or modify the designation, rights, preferences, privileges and restrictions of the shares of each series and to increase or decrease the number of shares of any series of preferred stock, all without any further vote or action by our stockholders. It is not possible to state the actual effect of the issuance of any shares of preferred stock on the rights of holders of common stock until our board of directors determines the specific rights attached to that preferred stock.

Registration Rights

Under a Registration Rights Agreement, dated June 25, 2002, between us and Technical Olympic, we agreed with Technical Olympic that we would register under the Securities Act the resale of all of the shares of common stock or securities issued in respect of, or in exchange for, such common stock then held, or from time to time thereafter held, by Technical Olympic. Technical Olympic had the right to request that we file, and use our best efforts to have declared effective as soon as practicable, a registration statement with the SEC at any time (subject to the aggregate value of the registrable securities being at

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least \$2,000,000 and certain cut-back provisions). We are not required to file such a registration statement more frequently than once every six months. Furthermore, if we are eligible to use a Form S-3, we have agreed to file, and use our best efforts to have declared effective, a shelf registration statement with the SEC upon the request of Technical Olympic (subject to the registrable securities having a minimum aggregate disposition price of at least \$2,000,000). We must use our best efforts to keep the shelf registration statement continuously effective. We will not be required to file a shelf registration statement more than twice in any twelve-month period. In addition, if we registered the sale of any of our securities by us or any other holder of our securities in connection with an underwritten offering, Technical Olympic had the right to request that its shares be included in such registration statement, subject to certain cut-back provisions.

Pursuant to our agreement with Technical Olympic, Technical Olympic S.A. requested that we prepare and file a registration statement on Form S-1 with respect to this offering. This prospectus will form part of the Form S-1. As a result of the restructuring transaction, the shares of our common stock owned by Technical Olympic were transferred to Technical Olympic S.A. and all of Technical Olympic's rights and obligations under the Registration Rights Agreement inured to the benefit of Technical Olympic S.A.

Anti-Takeover Effects of Delaware Law and our Certificate of Incorporation and Bylaws

Certain provisions of Delaware law and our certificate of incorporation and bylaws, summarized below, may discourage, delay, defer or prevent a tender offer or takeover attempt that a stockholder might consider in its best interest, including those attempts that might result in a premium over the market price for shares held by our stockholders.

Pursuant to Section 203(b)(1) of the Delaware corporate law, our certificate of incorporation provides that the provisions of Section 203 shall not apply to us. However, as our controlling stockholder, Technical Olympic S.A. has the power to amend our certificate of incorporation at any time. In general, Section 203 prohibits a publicly-held Delaware corporation from engaging in a business combination with an interested stockholder for a period of three years after the time such stockholder became an interested stockholder unless, subject to exceptions, the business combination or the transaction in which the person became an interested stockholder is approved in a prescribed manner. A business combination includes a merger, asset or stock sale, or other transaction resulting in a financial benefit to the interested stockholder. An interested stockholder is a person who, together with affiliates and associates, owns, or within three years prior, did own, 15% or more of the corporation's voting stock. If applicable, these provisions may have the effect of delaying, deferring or preventing a change in control without further action by the stockholders.

Our certificate of incorporation provides that our board of directors may issue shares of our authorized but unissued common stock and preferred stock without stockholder approval. These additional shares may be utilized for a variety of corporate purposes, including future public or private offerings to raise additional capital, corporate acquisitions or employee benefit plans. The existence of authorized but unissued and unreserved common stock and preferred stock may enable our board of directors to issue shares to persons friendly to current management, which could render more difficult or discourage an attempt to obtain control of our company by means of a proxy contest, tender offer, merger or otherwise, and thereby protect the continuity of our management.

Our bylaws provide that special meetings of stockholders can be called only by the board of directors, the Chairman of the Board, if any, or the President. Moreover, the business permitted to be conducted at any special meeting of stockholders is limited to the business brought before the meeting by the board of directors, the Chairman of the Board, if any, or the President. Our bylaws provide that stockholders must follow an advance notification procedure for certain stockholder nominations of candidates for the board of directors and for certain other stockholder business to be conducted at an annual meeting or special meeting.

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Indemnification of Officers and Directors

As permitted by the Delaware General Corporation Law, we have included a provision in our certificate of incorporation to eliminate the personal liability of our officers and directors incurred by them solely by reason of their service to our company.

Transfer Agent

The Transfer Agent and Registrar for our common stock is Equiserve Trust Company, N.A.

SHARES ELIGIBLE FOR FUTURE SALE

Upon completion of this offering, we will have 29,889,036 shares of our common stock outstanding. All shares of our common stock after this offering, other than 22,865,936 shares held by the selling stockholder and our other affiliates (22,190,936 shares if the over-allotment is exercised in full), will be freely tradable without restriction under the Securities Act unless those shares are acquired and held by an affiliate of our company. Sales of shares of our common stock by affiliates will be subject to the volume limitations and other restrictions set forth in Rule 144 under the Securities Act. We, the selling stockholder and our officers and directors have agreed not to sell or otherwise dispose of any shares of our common stock or securities convertible into or exchangeable for shares of our common stock for a period of 90 days after the completion of this offering, subject to certain exceptions.

In addition to outstanding shares eligible for sale, we have reserved 4,000,000 shares of common stock issuable upon exercise of outstanding stock options under our Annual and Long-Term Incentive Plan, of which 3,436,491 are issuable under currently outstanding options. We have registered the issuance of all of these shares under the Securities Act, and therefore, these shares will be freely tradable when issued, subject to the volume limitations of Rule 144 in the case of shares held by our affiliates.

Following the offering, Technical Olympic S.A. will continue to have the right to cause us to register for sale under the Securities Act all or part of the shares of our common stock held by it. See [Description of Capital Stock](#) [Registration Rights](#).

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MATERIAL UNITED STATES FEDERAL TAX CONSIDERATIONS TO NON-U.S. HOLDERS

The following is a general summary of the material United States federal income and estate tax considerations to a Non-U.S. Holder (as defined below) relevant to the ownership and disposition of shares of common stock purchased in this offering. This summary is based on the Internal Revenue Code of 1986, as amended (the Code), final, temporary and proposed United States Treasury regulations promulgated thereunder, Internal Revenue Service (IRS) rulings, official pronouncements and judicial decisions, all as in effect on the date hereof and all of which are subject to change, possibly with retroactive effect, or different interpretations. This summary does not discuss all the tax consequences that may be relevant to a particular Non-U.S. Holder in light of the holder's particular circumstances and it is not intended to be applicable in all respects to all categories of Non-U.S. Holders, some of whom may be subject to special rules not discussed below. The discussion below deals only with shares of common stock held as capital assets within the meaning of the Code, and does not address purchasers of the common stock that may be subject to special rules. Purchasers that may be subject to special rules include:

some U.S. expatriates;

financial institutions;

insurance companies;

partnerships or other pass-through entities;

tax-exempt entities;

dealers in securities or currencies;

traders in securities;

holders whose functional currency is not the U.S. dollar; and

persons that hold the common stock as part of a straddle, hedge, conversion or other integrated transaction.

The following discussion does not address the U.S. federal income tax consequences of persons who hold the common stock through a partnership or other pass-through entity. In addition, the following discussion does not address any state, local or foreign tax considerations that may be relevant to a Non-U.S. Holder's decision to purchase shares of common stock. You should consult your own tax advisor regarding the particular U.S. federal, state and local and foreign income and other tax consequences of acquiring, owning and disposing of the common stock that may be applicable to you.

Special rules may apply to certain Non-U.S. Holders, such as controlled foreign corporations, passive foreign investment companies, and foreign personal holding companies, that are subject to special treatment under the Code. Such entities should consult their own tax advisors to determine the U.S. federal, state, local and other tax consequences that may be relevant to them.

For purposes of the federal income tax portion of this discussion, a Non-U.S. Holder means a beneficial owner of common stock that is a nonresident alien or a corporation, trust or estate that is not (1) a corporation created or organized in or under the laws of the United States or any political subdivision thereof, (2) an estate the income of which is subject to United States federal income taxation regardless of its source or (3) a trust (a) that is subject to the supervision of a court within the United States and the control of one or more United States persons as described in section 7701(a)(30) of the Code or (b) that has a valid election in effect under applicable United States Treasury regulations to be treated as a U.S. person. For purposes of the federal estate tax portion of this discussion, a Non-U.S. Holder means a beneficial owner of common stock who is an individual who is not domiciled in the United States. A person acquires a domicile in the United States by living in the United States, even for a brief period, with no definite present intention of later removing from the United States. If domicile exists in the United States, an intention to change domicile does not actually effect such a change unless accompanied by an actual removal from the United States.

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ALL NON-U.S. HOLDERS ARE ADVISED TO CONSULT THEIR OWN TAX ADVISORS REGARDING THE FEDERAL, STATE, LOCAL AND FOREIGN TAX CONSEQUENCES OF THE PURCHASE, OWNERSHIP AND DISPOSITION OF SHARES OF COMMON STOCK IN LIGHT OF THEIR OWN PARTICULAR CIRCUMSTANCES.

Dividends on Common Stock

Generally, any dividends paid to a Non-U.S. Holder of common stock will be subject to United States federal withholding tax at a rate of 30% of the amount of the dividend, or at a lower applicable income tax treaty rate. However, if the dividend is effectively connected with the conduct of a United States trade or business of a Non-U.S. Holder (and is attributable to a U.S. permanent establishment of such Non-U.S. Holder, if an income tax treaty applies) it generally will be subject to United States federal income tax on a net income basis at ordinary federal income tax rates (in which case the branch profits tax at 30% (or such lower rate as may be specified in an applicable income tax treaty) may also apply if such Non-U.S. Holder is a foreign corporation), and assuming certain certification requirements are met, will not be subject to the 30% withholding tax.

United States Treasury regulations require a Non-U.S. Holder to provide certain certifications under penalties of perjury that such holder is not a United States person in order to obtain treaty benefits (and avoid backup withholding as discussed below).

A Non-U.S. Holder of common stock eligible for a reduced rate of United States withholding tax pursuant to an income tax treaty may obtain a refund of any excess amounts withheld by filing an appropriate claim for refund with the IRS.

Disposition of Common Stock

Subject to the discussion of backup withholding below, any capital gain realized upon a sale or other disposition of common stock by a Non-U.S. Holder ordinarily will not be subject to United States federal income tax unless (1) the gain is effectively connected with a trade or business conducted by such Non-U.S. Holder within the United States (and is attributable to a U.S. permanent establishment of such holder, if an income tax treaty applies) in which case, the Non-U.S. Holder will be subject to United States federal income tax on the net gain derived from the sale under regular graduated United States federal income tax rates, and if the Non-U.S. Holder is a foreign corporation, the branch profits tax at 30% of the Non-U.S. Holder's effectively connected earnings and profits within the meaning of the Code for the taxable year, as adjusted for certain items, (or such lower rate as may be specified in an applicable income tax treaty) may also apply, or (2) in the case of a Non-U.S. Holder that is an individual who holds the common stock as a capital asset, such Non-U.S. Holder is present in the United States for a period or periods aggregating 183 days or more in the taxable year of the sale or other disposition and certain other requirements are met (in which case the holder will be subject to a flat 30% tax on the gain derived from the sale, which may be offset by United States source capital losses, even though the individual is not considered a resident of the United States), or (3) we are or have been a United States real property holding corporation (a USRPHC) for United States federal income tax purposes at any time within the lesser of (a) the five-year period ending on the date of the sale or other disposition and (b) the Non-U.S. Holder's holding period, and, in each case, no income tax treaty exception is applicable. We believe that we are currently a USRPHC and will remain a USRPHC in the future. However, any gain recognized by a Non-U.S. Holder on the disposition of the common stock still would not be subject to U.S. federal income tax if the common stock were to be regularly traded (within the meaning of applicable United States Treasury regulations) on an established securities market (such as, for example, the Nasdaq National Market) and the Non-U.S. Holder did not own, directly or constructively, more than 5% of the outstanding common stock at any time during the shorter of (a) the five-year period ending on the date of the sale or other disposition and (b) the Non-U.S. Holder's holding period. We believe that upon the consummation of the offering the common stock will be regularly traded (within the meaning of applicable United States Treasury regulations) on an established securities market, although no

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assurance can be given that this will not change in the future. Non-U.S. Holders should consult their tax advisors to determine whether an income tax treaty is applicable.

Federal Estate Taxes

Common stock that is beneficially owned by an individual Non-U.S. Holder at the time of death will be included in the individual's gross estate for United States federal estate tax purposes, unless an applicable estate tax treaty provides otherwise. The individual's gross estate might also include the value of common stock which is held indirectly by the individual through one or more domestic or foreign entities. Non-U.S. holders are encouraged to consult their tax advisors regarding the inclusion of the value of the common stock in their gross estate in cases where it is owned indirectly through one or more entities.

Backup Withholding and Information Reporting

Dividends on common stock paid to a Non-U.S. Holder will generally be exempt from backup withholding tax, provided that Non-U.S. holders meet applicable certification requirements or otherwise establishes an exemption. Non-U.S. holders that fail to meet these requirements will be subject to backup withholding at the rate of 28%.

Payments of the proceeds from the sale by a Non-U.S. Holder of shares of common stock made by or through a foreign office of a broker will not be subject to information reporting or backup withholding except that if the broker is, for United States tax purposes, (i) a U.S. person, (ii) a controlled foreign corporation (as defined in the Code), (iii) a foreign person 50% or more of whose gross income is effectively connected with the conduct of a United States trade or business for a specified three-year period, or (iv) a foreign partnership, if at any time during its tax year, one or more of its partners are U.S. persons, as defined in Treasury regulations, who in the aggregate hold more than 50% of the income or capital interest in the partnership or if, at any time during its tax year, the foreign partnership is engaged in a U.S. trade or business, then information reporting and/or backup withholding may apply to these payments if the Non-U.S. Holder does not meet applicable certification requirements or otherwise established an exemption. Payments of the proceeds from the sale of shares of common stock by or through the United States office of a broker will be subject to information reporting and backup withholding unless the Non-U.S. Holder certifies under penalties of perjury that it is a Non-U.S. Holder or otherwise establishes an exemption from information reporting and backup withholding.

Any amounts withheld under the backup withholding rules may be allowed as a refund or a credit against such Non-U.S. Holder's United States federal income tax liability provided the required information is furnished to the IRS.

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UNDERWRITING

Citigroup Global Markets Inc. and UBS Securities LLC are acting as joint book-running managers of the offering and are acting as representatives of the underwriters named below. We, the selling stockholder and the underwriters named below have entered into an underwriting agreement concerning the shares offered hereby. Subject to conditions, each underwriter has severally agreed to purchase the number of shares indicated in the following table. Subject to the terms and conditions set forth in the underwriting agreement, the underwriters will be obligated to purchase all of the shares offered hereby if any of the shares are purchased.

Underwriters	Number of Shares
Citigroup Global Markets Inc.	
UBS Securities LLC	
Total	4,500,000

If the underwriters sell more shares than the total number set forth in the table above, the underwriters have a 30-day option to buy up to an additional 675,000 shares from the selling stockholder at the public offering price set forth on the cover of this prospectus less the underwriting discounts and commissions. If any shares are purchased under this option, the underwriters will severally purchase shares in approximately the same proportion as set forth in the table above.

The following table shows the per share and total underwriting discounts and commissions we and the selling stockholder will pay to the underwriters. These amounts are shown assuming both no exercise and full exercise of the underwriters' option to purchase up to an additional 675,000 shares.

	Fees Paid by Us	Fees Paid by the Selling Stockholder	
		No exercise	Full exercise
Per share			
Total			

Pursuant to the terms of the Registration Rights Agreement between us and the selling stockholder, we are responsible for all expenses, other than underwriting discounts and commissions, related to this offering. We estimate that the total expenses of the offering payable by us will be approximately \$. Expenses include the Securities and Exchange Commission and NASD filing fees, printing, legal, accounting and transfer agent and registrar fees and other miscellaneous fees and expenses.

Shares sold by the underwriters to the public will initially be offered at the public offering price set forth on the cover of this prospectus. Any shares sold by the underwriters to securities dealers may be sold at a discount of up to \$ per share from the public offering price. Any of these securities dealers may resell any shares purchased from the underwriters to other brokers or dealers at a discount of up to \$ per share from the public offering price. If all the shares are not sold at the public offering price, the representatives may change the offering price and the other selling terms. Sales of shares made outside of the United States may be made by affiliates of the underwriters. Upon execution of the underwriting agreement, the underwriters will be obligated to purchase the shares at the prices and upon the terms stated therein, and, as a result, will thereafter bear any risk associated with changing the offering price to the public or other selling terms.

We, our directors and executive officers, and the selling stockholder have agreed with the underwriters not to offer, sell, contract to sell, hedge or otherwise dispose of, directly or indirectly, any shares of our common stock or securities convertible into or exchangeable for shares of common stock until after the date that is 90 days after the date of this prospectus, without the prior written consent of Citigroup Global Markets Inc. and UBS Securities LLC. This agreement does not generally apply to the exercise of options under our employee benefits plans.

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In connection with the offering, UBS Securities LLC on behalf of the underwriters may purchase and sell shares of common stock in the open market. These transactions may include stabilizing transactions. Stabilizing transactions consist of bids or purchases made for the purpose of preventing or retarding a decline in the market price of our common stock while the offering is in progress. These transactions may also include short sales and purchases to cover positions created by short sales. Short sales involve the sale by the underwriters of a greater number of shares than they are required to purchase in the offering. Short sales may be either covered short sales or naked short sales. Covered short sales are sales made in an amount not greater than the underwriters' over-allotment option to purchase additional shares in the offering. The underwriters may close out any covered short position by either exercising their over-allotment option or purchasing shares in the open market. In determining the source of shares to close out the covered short position, the underwriters will consider, among other things, the price of shares available for purchase in the open market as compared to the price at which they may purchase shares through the over-allotment option. Naked short sales are in excess of the over-allotment option. The underwriters must close out any naked short position by purchasing shares in the open market. A naked short position is more likely to be created if the underwriters are concerned that there may be downward pressure on the price of the shares in the open market after pricing that could adversely affect investors who purchase common stock in the offering.

The underwriters also may impose a penalty bid. This occurs when a particular underwriter repays to the underwriters a portion of the underwriting discount received by it because the underwriters have repurchased shares sold by or for the account of that underwriter in stabilizing or short covering transactions.

These activities by the underwriters may stabilize, maintain or otherwise affect the market price of the common stock. As a result, the price of the common stock may be higher than the price that otherwise might exist in the open market. If these activities are commenced, they may be discontinued by the underwriters at any time. These transactions may be effected on the Nasdaq National Market or otherwise.

In addition, in connection with this offering, some of the underwriters (and selling group members) may engage in passive market making transactions in the common stock on the Nasdaq National Market, prior to the pricing and completion of this offering. Passive market making consists of displaying bids on the Nasdaq National Market no higher than the bid prices of independent market makers and making purchases at prices no higher than those independent bids and effected in response to order flow. Net purchases by a passive market maker on each day are limited to a specified percentage of the passive market maker's average daily trading volume in the common stock during a specified period and must be discontinued when that limit is reached. Passive market making may cause the price of the common stock to be higher than the price that otherwise would exist in the open market in the absence of those transactions. If the underwriters commence passive market making transactions, they may discontinue them at any time.

We and the selling stockholder have agreed to indemnify the several underwriters against some liabilities, including liabilities under the Securities Act, and to contribute to payments that the underwriters may be required to make in respect thereof.

In connection with this offering, certain of the underwriters or securities dealers may distribute prospectuses electronically.

The underwriters and their affiliates have in the past performed investment banking, commercial lending and financial advisory services for us and our affiliates for which they have received customary compensation, and they may from time to time do the same in the future. An affiliate of Citigroup Global Markets Inc. is an agent and lender under our revolving credit facility. Approximately \$56.8 million of the net proceeds from this offering will be used to repay borrowings under our revolving credit facility.

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LEGAL MATTERS

Akerman Senterfitt will pass upon the validity of the common stock offered by this prospectus. Cahill Gordon & Reindel LLP will pass upon certain legal matters for the underwriters.

EXPERTS

The consolidated financial statements of Technical Olympic USA, Inc. and subsidiaries at December 31, 2002 and 2001, and for each of the two years in the period ended December 31, 2002, appearing in this Prospectus and Registration Statement have been audited by Ernst & Young LLP, independent certified public accountants, and at December 31, 2000, and for the year then ended, by BDO Seidman, LLP, independent certified public accountants, as set forth in their respective reports thereon appearing elsewhere herein, and are included in reliance upon such reports given the authority of such firms as experts in accounting and auditing.

The consolidated financial statements of Engle Holdings Corp. and subsidiaries at December 31, 2001, and for the year then ended, appearing in this Prospectus and Registration Statement have been audited by Ernst & Young LLP, independent certified public accountants, and at December 31, 2000, and for the periods from November 22, 2000 to December 31, 2000 and November 1, 2000 to November 21, 2000, and each of the two years in the period ended October 31, 2000, by BDO Seidman LLP, independent certified public accountants, as set forth in their respective reports thereon appearing elsewhere herein, and are included in reliance upon such reports given the authority of such firms as experts in accounting and auditing.

WHERE YOU CAN FIND ADDITIONAL INFORMATION

We file annual, quarterly and special reports, proxy statements and other information with the SEC under the Exchange Act. You may read and copy this information at, or obtain copies by mail at prescribed rates from, the Public Reference Room of the SEC, 450 Fifth Street, N.W., Washington, D.C. 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at (800) SEC-0330. The SEC also maintains an internet world wide web site that contains reports, proxy statements and other information about issuers, like us, who file reports electronically. The address of that site is <http://www.sec.gov>.

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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

The Board of Directors

Technical Olympic USA, Inc.

We have audited the accompanying consolidated statements of financial condition of Technical Olympic USA, Inc. (formerly known as Newmark Homes Corp.) and subsidiaries as of December 31, 2002 and 2001 and the related consolidated statements of income, stockholders equity, and cash flows for each of the two years in the period ended December 31, 2002. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Technical Olympic USA, Inc. (formerly known as Newmark Homes Corp.) and subsidiaries at December 31, 2002 and 2001, and the consolidated results of their operations and their cash flows for each of the two years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States.

ERNST & YOUNG LLP

Miami, Florida
January 31, 2003, except for
Note 5, as to which
the date is February 3, 2003

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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

The Board of Directors

Technical Olympic USA, Inc.

We have audited the accompanying consolidated statements of income, stockholders' equity, and cash flows of Technical Olympic USA, Inc. (formerly known as Newmark Homes Corp.) and subsidiaries (the Company) for the year ended December 31, 2000. These consolidated financial statements are the responsibility of management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation of the financial statements. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above, present fairly, in all material respects, the results of operations and cash flows of the Company for the year ended December 31, 2000, in conformity with accounting principles generally accepted in the United States of America.

BDO SEIDMAN, LLP

Los Angeles, California
January 31, 2001, except for Note 1
and Note 5, as to which the date
is June 25, 2002

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TECHNICAL OLYMPIC USA, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

	December 31,	
	2001	2002
	(Dollars in thousands, except share data)	
ASSETS		
Homebuilding:		
Cash and cash equivalents:		
Unrestricted	\$ 67,206	\$ 44,825
Restricted	7,738	23,645
Inventory	645,986	753,872
Property and equipment, net	10,694	13,862
Other assets	10,897	30,681
Goodwill, net	57,726	78,252
Westbrooke assets held for sale	117,160	
	917,407	945,137
Financial Services:		
Cash and cash equivalents:		
Unrestricted	7,930	4,386
Restricted	19,605	22,866
Mortgage loans held for sale	50,933	58,840
Other assets	3,295	3,659
	81,763	89,751
Total assets	\$ 999,170	\$ 1,034,888
LIABILITIES AND STOCKHOLDERS EQUITY		
Homebuilding:		
Accounts payable and other liabilities	\$ 56,295	\$ 96,820
Customer deposits	25,674	24,564
Consolidated land bank obligations	30,022	16,288
Homebuilding borrowings	308,697	413,110
Westbrooke liabilities associated with assets held for sale	71,800	
	492,488	550,782
Financial Services:		
Accounts payable and other liabilities	18,828	21,560
Financial services borrowings	38,689	48,309
	57,517	69,869
Total liabilities	550,005	620,651
Minority interest	35,795	9,092
Commitments and contingencies		
Stockholders' equity:		
Common stock - \$.01 par value; 67,000,000 shares authorized and 27,878,787 shares issued and outstanding	279	279
Additional paid-in capital	322,400	322,400
Retained earnings	90,691	82,466

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Total stockholders' equity	<u>413,370</u>	<u>405,145</u>
Total liabilities and stockholders' equity	<u>\$ 999,170</u>	<u>\$ 1,034,888</u>

See accompanying notes to consolidated financial statements.

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Table of Contents**TECHNICAL OLYMPIC USA, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME**

	Year Ended December 31,		
	2000	2001	2002
(Dollars in thousands, except share data)			
Homebuilding:			
Revenues:			
Homes sales	\$ 540,323	\$ 1,374,551	\$ 1,349,713
Land sales	6,343	18,361	27,379
	<u>546,666</u>	<u>1,392,912</u>	<u>1,377,092</u>
Cost of sales:			
Home sales	434,736	1,091,626	1,075,875
Land sales	6,203	16,660	24,430
	<u>440,939</u>	<u>1,108,286</u>	<u>1,100,305</u>
Gross profit	105,727	284,626	276,787
Selling, general and administrative expenses	63,832	152,063	163,726
Depreciation and amortization	3,112	8,849	5,952
Severance and merger related expenses		2,643	19,963
Loss on early retirement of debt			5,411
Other (income) expense	2,264	(3,941)	(5,838)
	<u>36,519</u>	<u>125,012</u>	<u>87,573</u>
Homebuilding pretax income	36,519	125,012	87,573
Financial Services:			
Revenues	2,562	32,659	40,214
Expenses	1,635	17,688	20,846
	<u>927</u>	<u>14,971</u>	<u>19,368</u>
Financial Services pretax income	927	14,971	19,368
Income from continuing operations before income taxes	37,446	139,983	106,941
Income tax expense	13,672	52,218	39,900
	<u>23,774</u>	<u>87,765</u>	<u>67,041</u>
Income from continuing operations	23,774	87,765	67,041