

TOYS R US INC
Form 10-Q
December 18, 2007

Table of Contents

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

FORM 10-Q

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended November 3, 2007
Commission file number 1-11609**

TOYS R US, INC.
(Exact name of registrant as specified in its charter)

Delaware
**(State or other jurisdiction of
incorporation or organization)**

22-3260693
**(IRS Employer
Identification Number)**

One Geoffrey Way Wayne, New Jersey
(Address of principal executive offices)

07470
(Zip code)

(973) 617-3500
(Registrant's telephone number, including area code)

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

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

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

As of November 30, 2007, there were outstanding 1,000 shares of common stock of Toys R Us, Inc. (all of which are owned by Toys R Us Holdings, Inc., our holding company, and are not publicly traded).

TOYS R US, INC. AND SUBSIDIARIES
TABLE OF CONTENTS

| | PAGE |
|---|-------------|
| <u>PART I FINANCIAL INFORMATION</u> | |
| <u>Item 1. Financial Statements (Unaudited)</u> | |
| <u>Condensed Consolidated Balance Sheets as of November 3, 2007, February 3, 2007, and October 28, 2006 (As restated)</u> | 3 |
| <u>Condensed Consolidated Statements of Operations for the thirteen and thirty-nine weeks ended November 3, 2007 and October 28, 2006</u> | 4 |
| <u>Condensed Consolidated Statements of Cash Flows for the thirty-nine weeks ended November 3, 2007 and October 28, 2006</u> | 5 |
| <u>Condensed Consolidated Statement of Stockholder's Deficit for the thirty-nine weeks ended November 3, 2007</u> | 6 |
| <u>Notes to the Condensed Consolidated Financial Statements</u> | 7 |
| <u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 21 |
| <u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u> | 34 |
| <u>Item 4. Controls and Procedures</u> | 34 |
| <u>PART II OTHER INFORMATION</u> | |
| <u>Item 1. Legal Proceedings</u> | 36 |
| <u>Item 1A. Risk Factors</u> | 36 |
| <u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u> | 36 |
| <u>Item 3. Defaults Upon Senior Securities</u> | 36 |
| <u>Item 4. Submission of Matters to a Vote of Security Holders</u> | 36 |
| <u>Item 5. Other Information</u> | 36 |
| <u>Item 6. Exhibits</u> | 36 |
| <u>SIGNATURE</u> | 37 |
| <u>INDEX TO EXHIBITS</u> | 38 |
| <u>EX-3.3: AMENDED AND RESTATED CERTIFICATE OF INCORPORATION</u> | |
| <u>EX-10.1: AMENDED AND RESTATED 2005 MANAGEMENT EQUITY PLAN</u> | |

EX-31.1: CERTIFICATION
EX-31.2: CERTIFICATION
EX-32.1: CERTIFICATION
EX-32.2: CERTIFICATION

Table of ContentsPART I FINANCIAL INFORMATION**Item 1. Financial Statements**

TOYS R US, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)
(In millions)

| | November 3, 2007 | February 3, 2007 | October 28, 2006 (As restated) |
|--|------------------------|------------------------|---|
| ASSETS | | | |
| <i>Current Assets:</i> | | | |
| Cash and cash equivalents | \$ 240 | \$ 765 | \$ 393 |
| Accounts and other receivables | 179 | 230 | 142 |
| Merchandise inventories | 3,308 | 1,690 | 3,073 |
| Income tax receivable | 144 | | |
| Current deferred tax assets | 77 | 43 | 130 |
| Prepaid expenses and other current assets | 159 | 129 | 137 |
| | | | |
| Total current assets | 4,107 | 2,857 | 3,875 |
| Property and equipment, net | 4,391 | 4,333 | 4,331 |
| Goodwill, net | 365 | 365 | 365 |
| Deferred tax assets | 146 | 95 | 125 |
| Restricted cash | 126 | 148 | 151 |
| Other assets | 497 | 497 | 518 |
| | \$ 9,632 | \$ 8,295 | \$ 9,365 |
| | | | |
| LIABILITIES AND STOCKHOLDER S DEFICIT | | | |
| <i>Current Liabilities:</i> | | | |
| Short-term borrowings | \$ 243 | \$ 151 | \$ 285 |
| Accounts payable | 2,113 | 1,303 | 1,619 |
| Accrued expenses and other current liabilities | 900 | 848 | 775 |
| Income taxes payable | 8 | 142 | 125 |
| Current portion of long-term debt | 48 | 66 | 65 |
| | | | |
| Total current liabilities | 3,312 | 2,510 | 2,869 |
| Long-term debt | 6,265 | 5,722 | 6,716 |
| Deferred tax liabilities | 34 | 74 | 29 |
| Deferred rent liabilities | 257 | 248 | 258 |
| Other non-current liabilities | 371 | 282 | 265 |
| Minority interest in Toys R Us Japan | 130 | 134 | 131 |
| Stockholder s deficit | (737) | (675) | (903) |
| | \$ 9,632 | \$ 8,295 | \$ 9,365 |

See accompanying notes to the condensed consolidated financial statements.

Table of Contents

TOYS R US, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(In millions)

| | 13 Weeks Ended | | 39 Weeks Ended | |
|--|------------------------|------------------------|------------------------|------------------------|
| | November 3, 2007 | October 28, 2006 | November 3, 2007 | October 28, 2006 |
| Net sales | \$ 2,781 | \$ 2,534 | \$ 7,967 | \$ 7,371 |
| Cost of sales | 1,804 | 1,673 | 5,145 | 4,813 |
| Gross margin | 977 | 861 | 2,822 | 2,558 |
| Selling, general and administrative expenses | 924 | 802 | 2,536 | 2,280 |
| Depreciation and amortization | 94 | 92 | 291 | 305 |
| Net gains on sales of properties | (18) | (109) | (34) | (109) |
| Restructuring charges (reversals) and other | 3 | (1) | 4 | 4 |
| Total operating expenses | 1,003 | 784 | 2,797 | 2,480 |
| Operating (loss) earnings | (26) | 77 | 25 | 78 |
| Other (expense) income: | | | | |
| Interest expense | (136) | (141) | (378) | (401) |
| Interest income | 3 | 4 | 15 | 17 |
| Loss before income taxes and minority interest | (159) | (60) | (338) | (306) |
| Income tax benefit | 81 | 94 | 170 | 183 |
| Minority interest | 2 | 7 | 9 | 8 |
| Net (loss) income | \$ (76) | \$ 41 | \$ (159) | \$ (115) |

See accompanying notes to the condensed consolidated financial statements.

Table of Contents

TOYS R US, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In millions)

| | 39 Weeks Ended | |
|---|---------------------------------|-----------------------------|
| | November 3, 2007 | October 28, 2006 |
| Cash Flows from Operating Activities: | | |
| Net loss | \$ (159) | \$ (115) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization | 291 | 305 |
| Gains on sales of properties | (34) | (109) |
| Amortization of debt issuance costs | 23 | 50 |
| Deferred income taxes | (58) | (197) |
| Other | 8 | 3 |
| Changes in operating assets and liabilities: | | |
| Accounts and other receivables | 67 | 106 |
| Merchandise inventories | (1,575) | (1,366) |
| Prepaid expenses and other operating assets | (28) | (34) |
| Accounts payable | 746 | 264 |
| Accrued expenses and other liabilities | (73) | (113) |
| Income taxes payable and receivable | (154) | (32) |
| Net cash used in operating activities | (946) | (1,238) |
| Cash Flows from Investing Activities: | | |
| Capital expenditures | (218) | (170) |
| Decrease (increase) in restricted cash | 22 | (44) |
| Acquisition of minority interest in Toysrus.com | | (6) |
| Cash effect of the consolidation of Toys R Us-Japan | | 6 |
| Proceeds from sale of fixed assets | 56 | 217 |
| Net cash (used in) provided by investing activities | (140) | 3 |
| Cash Flows from Financing Activities: | | |
| Long-term debt borrowings | 760 | 3,298 |
| Short-term debt borrowings | 199 | 126 |
| Long-term debt repayment | (330) | (2,743) |
| Short-term debt repayment | (115) | (25) |
| Dividend paid to Toys R Us-Japan minority interest | (1) | (5) |
| Capitalized debt issuance costs | | (42) |
| Net cash provided by financing activities | 513 | 609 |
| Effect of exchange rate changes on cash and cash equivalents | 48 | 38 |
| Cash and cash equivalents: | | |

Edgar Filing: TOYS R US INC - Form 10-Q

| | | |
|--|--------|--------|
| Net decrease during period | (525) | (588) |
| Cash and cash equivalents at beginning of period | 765 | 981 |
| Cash and cash equivalents at end of period | \$ 240 | \$ 393 |

See accompanying notes to the condensed consolidated financial statements.

5

Table of Contents

TOYS R US, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS DEFICIT
(Unaudited)
(In millions)

| (\$ in millions) | Common Stock Issued ⁽¹⁾ | | Additional paid-in capital | Accumulated other comprehensive | Retained | Total stockholders |
|---|---------------------------------------|--------|----------------------------------|---------------------------------------|----------|-----------------------|
| | Shares | Amount | | loss | | |
| Balance, February 3, 2007 | | \$ | \$ 4 | \$ (95) | \$ (584) | \$ (675) |
| Cumulative effect of change in accounting principle, net of tax (Note 3) | | | | | (9) | (9) |
| Cumulative effect of adoption of FIN 48 (Note 6) | | | | | 21 | 21 |
| Net loss | | | | | (159) | (159) |
| Unrealized loss on hedged transactions, net of tax | | | | (1) | | (1) |
| Minimum pension liability adjustment, net of tax | | | | (1) | | (1) |
| Foreign currency translation adjustments, net of tax | | | | 83 | | 83 |
| Stock compensation expense | | | 4 | | | 4 |
| Balance, November 3, 2007 | | \$ | \$ 8 | \$ (14) | \$ (731) | \$ (737) |

(1) \$0.01 par value;
authorized
3,000 shares,
outstanding
1,000 shares.

See accompanying notes to the condensed consolidated financial statements.

Table of Contents

TOYS R US, INC. AND SUBSIDIARIES
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of presentation

As used herein, the Company, we, us, or our means Toys R Us, Inc., and its subsidiaries, except as expressly indicated or unless the context otherwise requires. The Condensed Consolidated Balance Sheets as of November 3, 2007, February 3, 2007, and October 28, 2006, the Condensed Consolidated Statements of Operations for the thirteen and thirty-nine weeks ended November 3, 2007 and October 28, 2006, the Condensed Consolidated Statements of Cash Flows for the thirty-nine weeks ended November 3, 2007 and October 28, 2006, and the Condensed Consolidated Statement of Stockholders' Deficit for the thirty-nine weeks ended November 3, 2007, have been prepared by us in conformity with accounting principles generally accepted in the United States of America (GAAP) for interim reporting, and in accordance with the requirements of this Quarterly Report on Form 10-Q. Our interim Condensed Consolidated Financial Statements are unaudited and are subject to year-end adjustments. In the opinion of management, the financial statements include all known adjustments (which consist primarily of normal, recurring accruals, estimates, and assumptions that impact the financial statements) necessary to present fairly the financial position at the balance sheet dates and the results of operations for the thirteen and thirty-nine weeks then ended. The Condensed Consolidated Balance Sheet at February 3, 2007 presented herein has been derived from our audited balance sheet included in our Annual Report on Form 10-K for the fiscal year ended February 3, 2007, but does not include all disclosures required by GAAP. These financial statements should be read in conjunction with the consolidated financial statements and footnotes thereto included within our Annual Report on Form 10-K for the fiscal year ended February 3, 2007. The results of operations for the thirteen and thirty-nine weeks ended November 3, 2007 and October 28, 2006 are not necessarily indicative of operating results of the full year.

As of February 4, 2007, we changed our accounting method for valuing our international wholly-owned subsidiaries merchandise inventories from the retail inventory method to the weighted average cost method. We have accounted for the change in accounting principle in accordance with Statement of Financial Accounting Standards (SFAS) No. 154, Accounting Changes and Error Corrections a replacement of APB Opinion No. 20 and FASB Statement No. 3 (SFAS 154). Refer to Note 3 to the Condensed Consolidated Financial Statements entitled Change in accounting principle for the impact on our Condensed Consolidated Financial Statements and further details.

As of February 4, 2007, we adopted the provisions of Financial Accounting Standards Board (FASB) Interpretation No. 48 (As amended) Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN 48). Refer to Note 6 to the Condensed Consolidated Financial Statements entitled Income taxes for the impact on our Condensed Consolidated Financial Statements.

In the fourth quarter of fiscal 2006, we identified errors in the way we had previously accounted for income taxes. We did not properly record deferred tax accounts on a net basis by legal entity and taxing jurisdiction, as required by SFAS No. 109 Accounting for Income Taxes (SFAS 109). As a result, we have restated the accompanying Condensed Consolidated Balance Sheet as of October 28, 2006. Refer to Note 13 to the Condensed Consolidated Financial Statements entitled Restatement of previously issued financial statements for further details.

In the fourth quarter of fiscal 2006, we adopted Securities and Exchange Commission (SEC) Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements (SAB 108). As permitted under the transition provisions of SAB 108, in the prior fiscal year, we recorded a cumulative \$(24) million adjustment to opening retained deficit as of January 29, 2006 and adjusted our financial results for the first three quarters of fiscal 2006. These adjustments relate principally to tax-related errors from fiscal years 2005 and 2004 with the balance applicable to years prior to fiscal 2004.

The impact of the adoption of SAB 108 and restatement on our interim results for the thirteen and thirty-nine weeks ended October 28, 2006 is summarized below:

Table of Contents

| | October 28, 2006 | |
|----------------------|----------------------------|----------------------------------|
| | Previously reported | As adjusted⁽¹⁾ |
| (In millions) | | |
| Deferred tax assets | \$ 610 | \$ 125 |
| Income taxes payable | 107 | 125 |
| Stockholders deficit | (878) | (903) |

(1) As adjusted amounts include the impact of the restatement (See Note 13 entitled Restatement of previously issued financial statements) and the adoption of SAB 108.

| | 13 Weeks Ended October 28, 2006 | | 39 Weeks Ended October 28, 2006 | |
|----------------------|--|--------------------|--|--------------------|
| | Previously reported | As adjusted | Previously reported | As adjusted |
| (In millions) | | | | |
| Income tax benefit | \$ 82 | \$ 94 | \$ 184 | \$ 183 |
| Net (loss) income | 29 | 41 | (114) | (115) |

During the first three quarters of fiscal 2006, we presented certain immaterial other non-product revenue as a reduction in Selling, general and administrative expenses. We have restated Net sales and Selling, general and administrative expenses in the thirteen and thirty-nine week periods ended October 28, 2006 to correctly present other non-product revenue in Net sales. This resulted in an increase in Net sales and an increase in Selling, general and administrative expenses. Refer to Note 13 to the Condensed Consolidated Financial Statements entitled Restatement of previously issued financial statements for further details.

Table of Contents**2. Restructuring and other charges**

Our Condensed Consolidated Statements of Operations for the thirteen and thirty-nine weeks ended November 3, 2007 and October 28, 2006 included the following pre-tax charges related to restructuring initiatives from prior years:

| (In millions) | 13 weeks ended | | 39 weeks ended | |
|---|------------------------|------------------------|------------------------|------------------------|
| | November 3, 2007 | October 28, 2006 | November 3, 2007 | October 28, 2006 |
| 2005 initiative | | | | |
| Restructuring charges (reversals) and other | \$ 1 | \$ (4) | \$ 2 | \$ 2 |
| Depreciation and amortization | | | | 24 |
| Cost of sales | | | | 3 |
| Total charges related to 2005 initiative | \$ 1 | \$ (4) | \$ 2 | \$ 29 |
| 2003 and prior years initiatives | | | | |
| Restructuring charges and other | \$ 2 | \$ 3 | \$ 2 | \$ 2 |
| Total charges related to 2003 and prior years initiatives | \$ 2 | \$ 3 | \$ 2 | \$ 2 |
| Total | \$ 3 | \$ (1) | \$ 4 | \$ 31 |

During the thirteen weeks ended November 3, 2007, we recorded charges of \$3 million based on changes in estimated lease commitments. During the thirteen weeks ended October 28, 2006, we recorded charges of \$3 million for changes in estimated lease commitments and disposal charges, which were offset by the reversal of \$4 million of reserves primarily for previously recorded lease commitments on properties sold during the third quarter of 2006.

During the thirty-nine weeks ended November 3, 2007, we recorded charges of \$7 million and reversed \$3 million of previously recorded reserves based on changes in estimated lease commitments. For the thirty-nine weeks ended October 28, 2006, we incurred \$10 million of charges relating to lease commitments and disposal charges, which were partially offset by the reversal of \$6 million of previously recorded reserves primarily related to lease commitments and severance. For the thirty-nine weeks ended October 28, 2006, we also incurred \$3 million of inventory markdowns and liquidator fees that were recorded in Cost of sales, and \$24 million of accelerated depreciation related to the closed and converted stores from our 2005 initiative.

Restructuring charges (reversals) related to prior years initiatives are primarily due to changes in management's estimates for events such as lease terminations, assignments and sublease income adjustments.

Our Condensed Consolidated Balance Sheets as of November 3, 2007, February 3, 2007 and October 28, 2006 included the following restructuring reserves in Accrued expenses and other current liabilities and Other non-current liabilities, which we believe are adequate to cover our commitments:

| (In millions) | November 3, 2007 | February 3, 2007 | October 28, 2006 |
|----------------------------------|------------------------|------------------------|------------------------|
| 2005 initiative | \$ 10 | \$ 11 | \$ 10 |
| 2003 and prior years initiatives | 51 | 63 | 67 |
| Total | \$ 61 | \$ 74 | \$ 77 |

We currently expect to utilize our remaining reserves through January 2019. The following is a description of our individual restructuring initiatives and a roll-forward of the related charges and reserves.

2005 initiative

On January 5, 2006, our Board of Directors approved the closing of 87 Toys R Us stores in the United States. As of April 2, 2006, all 87 stores had been closed. Twelve of these stores were converted into Babies R Us stores, which reopened in the fall of 2006, resulting in the permanent closure of 75 stores. As a result of the store closings, approximately 3,000 employee positions were eliminated.

A reconciliation of the activity by major type of cost during the thirty-nine weeks ended November 3, 2007 and October 28, 2006 is provided for this initiative below:

Table of Contents

| (In millions) | Lease | | Asset | | Inventory | Accelerated | Total |
|---------------------------------------|-------------|------------|-----------|-----------|--------------|-------------|-------|
| | commitments | impairment | Severance | markdowns | depreciation | | |
| Beginning balance at February 3, 2007 | \$ 11 | \$ | \$ | \$ | \$ | \$ | \$ 11 |
| Charges | 3 | | | | | | 3 |
| Reversals | (1) | | | | | | (1) |
| Utilized | (3) | | | | | | (3) |
| Ending balance at November 3, 2007 | \$ 10 | \$ | \$ | \$ | \$ | \$ | \$ 10 |
| Beginning balance at January 28, 2006 | \$ 1 | \$ | \$ 8 | \$ 34 | \$ | \$ | \$ 43 |
| Charges | 5 | 1 | | 3 | | 24 | 33 |
| Reversals | (3) | | (1) | | | | (4) |
| Utilized | (6) | (1) | (6) | (37) | | (24) | (74) |
| Reclassification ⁽¹⁾ | 12 | | | | | | 12 |
| Ending balance at October 28, 2006 | \$ 9 | \$ | \$ 1 | \$ | \$ | \$ | \$ 10 |

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

2003 and prior years initiatives

In fiscal 2003, we decided to close all 146 freestanding Kids R Us stores and all 36 freestanding Imaginarium stores, as well as three distribution centers that supported these stores, due to deterioration in their financial performance. In fiscal 2001, we closed stores, eliminated a number of staff positions, and consolidated five store support center facilities into our Global Store Support Center facility in Wayne, New Jersey. In fiscal 1998 and fiscal 1995, we had strategic initiatives to reposition our worldwide operations.

The following is a reconciliation of the activity during the thirty-nine weeks ended November 3, 2007 and October 28, 2006:

| (In millions) | 2003 initiative | 2001 initiative | 1998 and 1995 | Total |
|---------------------------------------|-----------------|-----------------|---------------|-------|
| Beginning balance at February 3, 2007 | \$ 4 | \$ 43 | \$ 16 | \$ 63 |
| Charges | | 4 | | 4 |
| Reversals | | | (2) | (2) |
| Utilized | (2) | (8) | (4) | (14) |
| Ending balance at November 3, 2007 | \$ 2 | \$ 39 | \$ 10 | \$ 51 |
| Beginning balance at January 28, 2006 | \$ 8 | \$ 51 | \$ 22 | \$ 81 |
| Charges | 3 | 1 | | 4 |

Edgar Filing: TOYS R US INC - Form 10-Q

| | | | | |
|------------------------------------|------|-------|-------|-------|
| Reversals | (1) | (1) | (2) | |
| Utilized | (5) | (7) | (4) | (16) |
| Ending balance at October 28, 2006 | \$ 5 | \$ 44 | \$ 18 | \$ 67 |

Table of Contents**3. Change in accounting principle**

As of February 4, 2007, we changed our accounting method for valuing merchandise inventories of our international wholly-owned subsidiaries from the retail inventory method to the weighted average cost method. This change followed the implementation of a perpetual inventory system in our international locations, excluding Toys R Us Japan, Ltd. (Toys-Japan), which already utilizes a similar system and follows the weighted average cost method. The weighted average cost method utilizes the newly available perpetual inventory records to value inventories. We plan to change our accounting method for valuing merchandise inventories for our U.S. divisions from the retail inventory method to the weighted average cost method in fiscal 2008 when our perpetual inventory system is implemented domestically.

Management believes the weighted average cost method is preferable over the retail inventory method because it results in greater precision in the determination of cost of sales and merchandise inventories. Our newly instituted perpetual inventory system provides management product level detail by store on both a weighted average cost and retail price basis. Management believes the weighted average cost method provides for a better matching of cost of sales with related sales. Cost of sales under the weighted average cost method will represent the weighted average cost of the individual item sold rather than the cost of an item based on an average margin realized on an entire department as under the retail method. As of November 3, 2007, February 3, 2007 and October 28, 2006, we valued approximately 38%, 10% and 9%, respectively, of merchandise inventories under the weighted average cost method, with the remainder valued under the retail inventory method.

In accordance with SFAS 154, we recorded the cumulative effect of the change in accounting principle as of February 4, 2007. We determined that retrospective application for periods prior to fiscal year 2007 is impracticable, as the period-specific information necessary to value the international merchandise inventories under the weighted average cost method is unavailable. As of February 4, 2007, the cumulative effect of this change in accounting principle was a reduction in merchandise inventory of \$13 million, an increase in deferred tax assets of \$4 million and a net increase in Stockholder s deficit of \$9 million.

For comparability purposes, the following table sets forth the effects of the change in accounting principle by comparing our Condensed Consolidated Balance Sheet (as reported under the weighted average cost method) to pro forma Condensed Consolidated Balance Sheet (as if merchandise inventories were valued under the retail inventory method) as of November 3, 2007:

Condensed Consolidated Balance Sheet

| (In millions) | As reported | Pro forma | Increase (decrease) from change in accounting ⁽¹⁾ |
|---|----------------|--------------|--|
| As of November 3, 2007 | | | |
| Merchandise inventories | \$ 3,308 | \$ 3,310 | \$ (2) |
| Total current assets | 4,107 | 4,109 | (2) |
| Total assets | 9,632 | 9,634 | (2) |
| Stockholder s deficit | (737) | (735) | (2) |
| Total liabilities and stockholder s deficit | 9,632 | 9,634 | (2) |

(1) Includes the cumulative effect of the change in accounting principle.

Table of Contents

The effects of the change in accounting principle on our Condensed Consolidated Statement of Operations (as reported under the weighted average cost method) to pro forma Condensed Consolidated Statement of Operations (as if merchandise inventories were valued under the retail inventory method) for the thirteen weeks ended November 3, 2007 were immaterial. The effects of the change in accounting principle for the thirty-nine weeks ended November 3, 2007 are as follows:

| (In millions) | As reported | Pro forma | Increase (decrease) from change in accounting |
|--|------------------------|----------------------|--|
| For the 39 Weeks Ended November 3, 2007 | | | |
| Cost of sales | \$ 5,145 | \$ 5,156 | \$ (11) |
| Gross margin | 2,822 | 2,811 | 11 |
| Operating earnings | 25 | 14 | 11 |
| Loss before income taxes and minority interest | (338) | (349) | 11 |
| Income tax benefit | 170 | 174 | (4) |
| Net loss | (159) | (166) | 7 |

12

Table of Contents**4. Short-term borrowings and long-term debt**

A summary of the Company's consolidated short-term borrowings and long-term debt as of November 3, 2007, February 3, 2007 and October 28, 2006 is outlined in the table below:

| (In millions) | November 3, 2007 | February 3, 2007 | October 28, 2006 |
|--|---------------------------------|---------------------------------|---------------------------------|
| Short-term borrowings | | | |
| Toys R Us Japan, Ltd. 0.75%-0.89% short-term bank loans due fiscal 2007 | \$ 243 | \$ 151 | \$ 285 |
| Long-term debt | | | |
| Note at an effective cost of 2.23% due in semi-annual installments through February 20, 2008 | 19 | 49 | 50 |
| LIBOR plus 3.00%-4.00% asset sale facility, due July 19, 2008 | | 44 | 44 |
| LIBOR plus 1.30% secured real estate loan, due August 9, 2008 ^(a) | 800 | 800 | 800 |
| LIBOR plus 3.00% unsecured credit agreement, due December 9, 2008 ^(b) | 1,300 | 1,300 | 1,300 |
| LIBOR plus 1.50%-2.00% multi-currency revolving credit facility, expires fiscal 2010 | 28 | | 190 |
| LIBOR plus 1.00%-3.75% \$2.0 billion secured revolving credit facility, expires fiscal 2010 | 489 | | 836 |
| 7.625% notes, due fiscal 2011 ^(c) | 518 | 522 | 523 |
| LIBOR plus 4.25% secured term loan facility, due fiscal 2012 | 797 | 800 | 800 |
| LIBOR plus 5.00% unsecured credit facility, due fiscal 2012 | 180 | 180 | |
| EURIBOR plus 1.50% French real estate credit facility, due fiscal 2012 | 93 | 84 | 82 |
| EURIBOR plus 1.50% Spanish real estate credit facility, due fiscal 2012 | 193 | 173 | 171 |
| 5.02% U.K. real estate credit facility, due fiscal 2013 | 741 | 700 | 675 |
| LIBOR plus 2.25% U.K. real estate credit facility, due fiscal 2013 | 132 | 121 | 118 |
| 7.875% notes, due fiscal 2013 ^(c) | 392 | 391 | 390 |
| Toys R Us-Japan, Ltd. 1.20%-2.80% loans due fiscal 2007-2020 | 161 | 152 | 156 |
| 7.375% notes, due fiscal 2018 ^(c) | 407 | 408 | 408 |
| 8.75% debentures, due fiscal 2021 ^(d) | 22 | 22 | 199 |
| Capital leases and other | 41 | 42 | 39 |
| | 6,313 | 5,788 | 6,781 |
| Less current portion | 48 | 66 | 65 |
| Total long-term debt | \$ 6,265 | \$ 5,722 | \$ 6,716 |

^(a) We have classified this loan as long-term debt because we have the contractual ability

and intent to extend the due date to August 9, 2010.

(b) We have the contractual ability and intent to extend the due date to December 7, 2010.

(c) Represents obligations of the Toys R Us, Inc. legal entity.

(d) Represents obligations of Toys R Us, Inc. and our subsidiary Toys R Us-Delaware, Inc. (Toys-Delaware).

As of November 3, 2007, we were in compliance with all of our financial covenants related to our outstanding debt. The total fair market value of our short-term borrowings and long-term debt, with a carrying value of \$6.6 billion at November 3, 2007, was \$6.2 billion. The total fair market value of our short-term borrowings and long-term debt approximated carrying value at February 3, 2007. The fair market values of our long-term debt are estimated using quoted market prices for the same or similar issues and other pertinent information available to management as of the end of the respective periods.

Borrowing availability

At November 3, 2007, under our \$2 billion secured revolving credit facility, we had \$489 million in borrowings outstanding, \$125 million of outstanding letters of credit, and remaining availability of \$1,380 million. In addition, under our multi-currency revolving credit facilities, we had \$28 million in borrowings outstanding and \$380 million of remaining availability. We have classified borrowings under these revolving credit facilities as long-term, as the revolving credit facilities expire in fiscal 2010. However, we may pay these facilities down within the next twelve months if we have the ability to do so either through additional long-term financing or through cash from operating activities.

Secured real estate loan, due August 9, 2008 (\$800 million at November 3, 2007)

On July 9, 2007, we notified the lenders for our \$800 million secured real estate loan that we were exercising our first maturity date extension option (the First Extension Option), which extended the maturity date of the loan from August 9, 2007 to August 9, 2008. The other key terms of the loan were not changed as a result of the extension. We have the ability and intent to exercise our two remaining maturity date extension options to August 2009 and August 2010. Pursuant to the First Extension Option, we were also required to extend our current interest rate cap through the end of the first maturity extension. Refer to Note 5 to the Condensed Consolidated Financial Statements entitled Derivative instruments and hedging activities for further details.

Table of Contents***Asset sale facility, due July 19, 2008 (\$0 at November 3, 2007)***

On June 1, 2007, Toys-Delaware repaid \$9 million of principal of the \$200 million asset sale facility with proceeds from the properties sold in the second quarter of fiscal 2007. On August 23, 2007, Toys-Delaware repaid an additional \$10 million of principal with proceeds from the lease termination agreement consummated during the second quarter of fiscal 2007. On November 2, 2007, Toys-Delaware repaid the remaining \$25 million outstanding principal balance with a portion of the \$29 million proceeds from the property sold during the third quarter of fiscal 2007. Refer to Note 10 to the Condensed Consolidated Financial Statements entitled *Net gains on sales of properties* for additional information on each transaction. As of November 3, 2007, we had fully repaid the \$200 million asset sale facility

Secured term loan facility, due fiscal 2012 (\$797 million at November 3, 2007)

On November 2, 2007, Toys-Delaware used the remaining \$4 million of the \$29 million proceeds from property sold during the third quarter of fiscal 2007 (refer to Note 10 to the Condensed Consolidated Financial Statements entitled *Net gains on sales of properties*) to repay a portion of the secured term loan facility.

U.K. real estate credit facility, due fiscal 2013 (\$741 million at November 3, 2007)

As previously described in our fiscal 2006 Annual Report on Form 10-K, during fiscal 2006, we identified Vanwall Finance PLC (*Vanwall*) as a variable interest entity established with the limited purpose of issuing the notes under the credit agreement with Toys R Us Properties (UK) Limited (*Toys Properties*), our indirect wholly-owned subsidiary, and certain related transactions. Our loan agreement with Vanwall requires the Company to indemnify Vanwall against any loss or liability that Vanwall incurs as a consequence of any part of the loan being repaid or prepaid, including costs relating to terminating all or part of their interest rate swap. Management has performed an analysis of Vanwall in accordance with Financial Interpretation (*FIN*) No. 46 (revised December 2003), *Consolidation of Variable Interest Entities* (*FIN 46(R)*) and has concluded that the Company is not the primary beneficiary of any gains or losses from Vanwall's interest rate swap and the entity should not be consolidated.

U.K. real estate credit facility, due fiscal 2013 (\$132 million at November 3, 2007)

On February 8, 2007, Toys Properties borrowed an additional \$4 million from the Junior Lender of our U.K. real estate credit facility under conditions previously specified in the original loan agreement dated February 8, 2006.

Guarantees

Toys R Us, Inc. currently guarantees 80% of Toys-Japan's three installment loans from a third party in Japan, totaling \$41 million. These loans have annual interest rates of 2.6% - 2.8%, are due from 2012 to 2014, and are reported as part of the Toys-Japan loans of \$161 million at November 3, 2007.

5. Derivative instruments and hedging activities

SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* (*SFAS 133*), as amended, establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. It requires the recording of all derivatives as either assets or liabilities on the balance sheet measured at estimated fair value and the recognition of the unrealized gains and losses. We record the fair market value of our derivatives, based on information provided by reliable third parties, as other assets and other non-current liabilities within our Condensed Consolidated Balance Sheets. The changes in fair value of our derivatives are recorded in the Condensed Consolidated Statements of Operations in Interest expense, unless the derivative is designated as a hedge. In certain defined conditions, a derivative may be specifically designated as a hedge for a particular exposure. The effective portion of a cash flow hedge is recorded to Other comprehensive loss; the ineffective portion of a cash flow hedge is recorded to Interest expense. For our derivatives that are designated under SFAS 133 as cash flow hedges, no material ineffectiveness existed at November 3, 2007 and October 28, 2006. We recorded less than \$1 million and \$1 million to Interest expense related to these cash flow hedges for the thirteen and thirty-nine weeks ended November 3, 2007, respectively. We reduced Interest expense by less than \$1 million and \$1 million related to these cash flow hedges for the thirteen and thirty-nine weeks ended October 28, 2006, respectively.

For the thirteen and thirty-nine weeks ended November 3, 2007, we recorded net charges to Interest expense of \$12 million and \$22 million, respectively, related to the change in fair value of our derivatives that do not qualify for hedge accounting. For the thirteen and thirty-nine weeks ended October 28, 2006 we recorded net charges to Interest expense of \$2 million and \$1 million, respectively, related to the change in fair value of our derivatives that did not

qualify for hedge accounting.

Table of Contents***Secured real estate loan, due August 9, 2008 (\$800 million at November 3, 2007)***

On July 27, 2007, we extended the interest rate caps on the \$800 million notional amount related to the secured real estate loan. The amount paid to extend the caps was less than \$1 million. The interest rate caps manage the variable cash flows associated with changes in the one-month LIBOR above 7.00% and mature in August 2008. The derivative contracts do not qualify for hedge accounting under SFAS 133.

Unsecured credit facility, due fiscal 2012 (\$180 million at November 3, 2007)

On May 24, 2007, we entered into an interest rate cap for \$91 million notional amount related to the \$180 million unsecured credit facility due fiscal 2012, as required by the credit agreement. The amount paid to enter into the cap was less than \$1 million. The interest rate cap manages the variable cash flows associated with changes in the one month LIBOR above 7.00% and matures in May 2009. The derivative contract does not qualify for hedge accounting under SFAS 133.

U.K. real estate credit facility, due fiscal 2013 (\$132 million at November 3, 2007)

On April 5, 2007, we entered into an interest rate swap for \$4 million notional amount related to the additional borrowings on the U.K. real estate credit facility made in February 2007 (See Note 4 entitled "Short-term borrowings and long-term debt"). The interest rate swap hedges the variable LIBOR for a fixed rate of interest of 5.69% until April 2013. The derivative contract is designated as a cash flow hedge under the long-haul method under SFAS 133.

6. Income taxes

The following table summarizes our income tax benefit and effective tax rates for the thirteen and thirty-nine weeks ended November 3, 2007 and October 28, 2006:

| | 13 Weeks Ended | | 39 Weeks Ended | |
|--|------------------------|------------------------|------------------------|------------------------|
| | November 3, 2007 | October 28, 2006 | November 3, 2007 | October 28, 2006 |
| (\$ in millions) | | | | |
| Loss before income taxes and minority interest | \$ (159) | \$ (60) | \$ (338) | \$ (306) |
| Income tax benefit | 81 | 94 | 170 | 183 |
| Effective tax rate | (50.9)% | (156.7)% | (50.3)% | (59.8)% |

The effective tax rates for the thirteen and thirty-nine weeks ended November 3, 2007 and October 28, 2006, respectively, were based primarily on our forecasted annualized effective tax rates, adjusted for discrete items that occurred within the periods presented. Our forecasted annualized effective tax rate was 50.3% compared to 34.5% in the same period last year. The difference between our forecasted annualized effective tax rates was primarily due to our current year determination to deduct rather than claim credits for foreign taxes.

For the thirteen weeks ended November 3, 2007, our effective tax rate was impacted primarily by additional income tax benefit resulting from the reversal of valuation allowance of \$10 million related to foreign tax credits. The additional income tax benefit was partially offset by income tax expense of \$3 million from adjustments to our FIN 48 liability and our current taxes payable. For the thirteen weeks ended October 28, 2006, our effective tax rate was impacted by additional income tax benefits primarily related to the reversal of valuation allowance of \$80 million. The income tax benefits were partially offset by income tax expense of \$10 million related to adjustments in certain estimated tax reserves and non-deductible officer compensation.

For the thirty-nine weeks ended November 3, 2007, our effective tax rate was primarily impacted by additional income tax benefits of \$11 million related to the reversal of valuation allowance and changes in tax laws. The additional income tax benefits were partially offset by income tax expense of \$8 million related to adjustments to our FIN 48 liability, adjustments to our current income taxes payable, and settlements of certain tax audits. For the thirty-nine weeks ended October 28, 2006, our effective tax rate was impacted by additional income tax benefits primarily related to the reversal of valuation allowance of \$86 million. The income tax benefits were offset by income tax expense of \$8 million related to adjustments in certain estimated tax reserves, non-deductible officer compensation, and changes in state tax laws.

In June 2006, the FASB issued FIN 48, which clarifies the accounting for uncertainty in income taxes. FIN 48 requires that we recognize in our financial statements the impact of a tax position taken or expected to be taken in a tax return, if that

Table of Contents

position is more likely than not of being sustained on audit, based on the technical merits of the position. We adopted the provisions of FIN 48 on February 4, 2007.

Upon adoption of FIN 48, we decreased our liability for unrecognized tax benefits by \$21 million (from \$133 million to \$112 million), which was accounted for as a cumulative effect reduction of retained deficit as of February 4, 2007. In addition, we have reflected additional unrecognized tax benefits and corresponding tax assets of \$148 million. As a result, the total amount of unrecognized tax benefits was \$260 million at February 4, 2007 (date of adoption). Of the \$260 million of unrecognized tax benefits, the amount that, if recognized, would affect our effective tax rate is \$112 million. The remaining \$148 million would affect our deferred tax accounts. Included within the unrecognized tax benefits recorded on February 4, 2007 was accrued interest and penalties of \$28 million and \$4 million, respectively. We accrue interest and penalties related to unrecognized tax benefits as a component of Income tax benefit on the Condensed Consolidated Statement of Operations.

We believe that it is reasonably possible that the total amount of unrecognized tax benefits will decrease by as much as \$47 million during the next 12 months as a result of settling uncertain intercompany tax positions in several of the jurisdictions in which we pay taxes.

At February 3, 2007, we reported tax reserves in the Income taxes payable line of our Condensed Consolidated Balance Sheet. As of November 3, 2007, we reported \$47 million of the reserve for unrecognized tax benefits in Accrued expenses and other current liabilities and \$109 million of the reserve for unrecognized tax benefits in Other non-current liabilities of our Condensed Consolidated Balance Sheet. These amounts do not include a portion of our unrecognized tax benefits, which have been recorded as a reduction of Deferred tax assets related to net operating losses. As of November 3, 2007, there have been no material changes to our unrecognized tax benefits since the date of adoption.

The Company or its subsidiaries are subject to taxation in the United States and various foreign jurisdictions. Of the major tax jurisdictions, the Company or its subsidiaries are subject to examination by the United States and Canada for the fiscal years 2003 to 2006, by France, Germany, and Spain for the fiscal years 2000 to 2006, by Japan for the fiscal years 2004 to 2006, and by the United Kingdom for fiscal years 2001 to 2006.

7. Comprehensive (loss) income

Comprehensive loss, net of taxes, is comprised of:

| | 13 Weeks Ended | | 39 Weeks Ended | |
|--|------------------------|------------------------|------------------------|------------------------|
| | November 3, 2007 | October 28, 2006 | November 3, 2007 | October 28, 2006 |
| (In millions) | | | | |
| Net (loss) income | \$ (76) | \$ 41 | \$ (159) | \$ (115) |
| Foreign currency translation adjustments, net of tax | 49 | (16) | 83 | (36) |
| Unrealized loss on hedged transactions, net of tax | (1) | (5) | (1) | (7) |
| Minimum pension liability adjustment, net of tax | (1) | | (1) | |
| Comprehensive (loss) income | \$ (29) | \$ 20 | \$ (78) | \$ (158) |

8. Segments

Our reportable segments are: Toys R Us-U.S. (Toys U.S.), which operates toy stores in 49 states and Puerto Rico and is responsible for our internet operations; Toys R Us-International (International), which operates and licenses or franchises toy stores in 34 foreign countries with wholly-owned operations in Australia, Austria, Canada, France, Germany, Portugal, Spain, Switzerland, and the United Kingdom, and consolidates the results of Toys-Japan; and Babies R Us (Babies), which operates stores in 42 states. We identify segments based on the information used by our chief operating decision maker to analyze performance and to allocate resources among each business unit of the Company. All intercompany transactions between the segments have been eliminated. Income tax information by segment has not been included as taxes are calculated at a company-wide level and are not allocated to each segment.

Table of Contents

A summary of operations by reportable segment is as follows:

| (In millions) | 13 Weeks Ended | | 39 Weeks Ended | |
|--|------------------------|------------------------|------------------------|------------------------|
| | November 3, 2007 | October 28, 2006 | November 3, 2007 | October 28, 2006 |
| Net sales | | | | |
| Toys R Us U.S. | \$ 1,040 | \$ 986 | \$ 3,058 | \$ 2,981 |
| Toys R Us International | 1,107 | 948 | 3,013 | 2,630 |
| Babies R Us | 634 | 600 | 1,896 | 1,760 |
| Total net sales | \$ 2,781 | \$ 2,534 | \$ 7,967 | \$ 7,371 |
| Operating (loss) earnings | | | | |
| Toys R Us U.S. | \$ (95) | \$ (54) | \$ (91) | \$ (63) |
| Toys R Us International | 37 | (6) | 31 | (18) |
| Babies R Us | 93 | 87 | 275 | 243 |
| Corporate and other charges | (76) | (60) | (220) | (189) |
| Net gains on sales of properties | 18 | 109 | 34 | 109 |
| Restructuring and other charges | (3) | 1 | (4) | (4) |
| Operating (loss) earnings | (26) | 77 | 25 | 78 |
| Interest expense | (136) | (141) | (378) | (401) |
| Interest income | 3 | 4 | 15 | 17 |
| Loss before income taxes and minority interest | \$ (159) | \$ (60) | \$ (338) | \$ (306) |

| (In millions) | November 3, 2007 | February 3, 2007 | October 28, 2006 |
|-------------------------------|------------------------|------------------------|------------------------|
| Merchandise inventories | | | |
| Toys R Us U.S. | \$ 1,663 | \$ 716 | \$ 1,631 |
| Toys R Us International | 1,260 | 637 | 1,104 |
| Babies R Us | 385 | 337 | 338 |
| Total merchandise inventories | \$ 3,308 | \$ 1,690 | \$ 3,073 |

(1) Refer to Note 3
Condensed
Consolidated
Financial
Statement
entitled Change
in accounting
principle for the
impact of the

change in
accounting
method for
valuing our
international
subsidiaries
inventories.

9. Litigation and legal proceedings

During the third quarter of fiscal 2007, we adjusted certain legal reserves due to changes in facts and circumstances of pending legal actions yielding no material change to the overall amount of our legal reserves.

As of the end of our fiscal 2005 year, Toysrus.com operated three co-branded on-line stores under a strategic alliance agreement with Amazon.com. On May 21, 2004, we filed a lawsuit against Amazon.com and its affiliated companies in the Superior Court of New Jersey, Chancery Division, Passaic County (the New Jersey Trial Court) to terminate our strategic alliance agreement with Amazon.com. On June 25, 2004, Amazon.com filed a counterclaim against us and our affiliated companies alleging breach of contract relating to inventory and selection requirements. On March 31, 2006, the New Jersey Trial Court entered its order granting our request for termination of the agreement and denying Amazon.com's request for relief on its counterclaim. On or about March 2, 2007, Amazon.com filed a Notice of Appeal of the New Jersey Trial Court's March 31, 2006 order and certain other related orders. On or about March 16, 2007, we filed a Notice of Cross-Appeal on the issue of whether the New Jersey Trial Court erred in denying our claim for damages caused by Amazon.com's material breach of the parties' strategic alliance agreement.

On June 2, 2006, Amazon.com filed a lawsuit against us in the Superior Court of Washington, County of King, (the Washington Court) for money damages allegedly arising from services it was required to provide to us during the wind-down period pursuant to the final order entered in the New Jersey Trial Court. The Washington Court stayed proceedings before it in favor of the New Jersey Trial Court, and the New Jersey Trial Court has ruled that Amazon.com is not entitled to the fees it sought for services it was required to provide during the wind-down period. The Washington Court has directed

Table of Contents

that any further litigation over these issues proceed in the New Jersey courts. We believe that Amazon.com's maintenance of the Washington Court lawsuit is without merit.

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

10. Net gains on sales of properties

During the third quarter of fiscal 2007, we sold our interest in an idle distribution center for gross proceeds of approximately \$29 million, resulting in a gain of \$18 million for the thirteen and thirty-nine weeks ended November 3, 2007.

During the second quarter of fiscal 2007, we consummated a lease termination agreement resulting in a net gain of \$10 million.

In the third quarter of fiscal 2006, Toys-Delaware and MAP 2005 Real Estate, LLC (MAP) (collectively referred to herein as Seller), both wholly-owned subsidiaries, consummated the sale of its interest in 38 properties, out of a total agreed upon sale of 42 properties, to Vornado Surplus 2006 Realty LLC, a Delaware limited liability company, an affiliate of Vornado Realty Trust, an indirect equity owner of the Company and the Seller for gross proceeds of approximately \$178 million. As a result of the sale of these properties, the Company recorded a gain of \$91 million for the thirteen and thirty-nine weeks ended October 28, 2006. In the first quarter of fiscal 2007, the Seller sold two additional properties for gross proceeds of approximately \$5 million and recorded a gain of \$3 million. During the second quarter of fiscal 2007, the Seller completed the sale of the two remaining properties for gross proceeds of \$9 million and recorded a gain of \$2 million.

In addition, during the third quarter of 2006, Toys R Us Properties Ltd. sold its interest in and assets related to a leased property in Cardiff, U.K. to an unrelated third party for gross proceeds of approximately \$26 million, resulting in a gain of \$21 million for the thirteen and thirty-nine weeks ended October 28, 2006.

11. Related party transactions***Transactions with the Sponsors***

We are indirectly owned by an investment group consisting of entities advised by or affiliated with Bain Capital Partners LLC, Kohlberg Kravis Roberts & Co., and Vornado Realty Trust (collectively, the Sponsors). The Sponsors provide management and advisory services to us pursuant to an advisory agreement executed at the closing of the Merger Transaction on July 21, 2005. We recorded management and advisory fees of \$4 million and \$12 million for the thirteen and thirty-nine weeks ended November 3, 2007, respectively. For the thirteen and thirty-nine weeks ended October 28, 2006, we recorded management and advisory fees of \$4 million and \$15 million, respectively.

From time to time, the Sponsors or their affiliates may acquire debt or debt securities issued by the Company or its subsidiaries in open market transactions or through loan syndications. On December 1, 2006, Toys-Delaware entered into an unsecured credit facility with a syndicate of financial institutions and other lenders. The syndicate includes affiliates of Vornado Realty Trust and Kohlberg Kravis Roberts & Co. L.P., all indirect equity owners of the Company, which each participated in 15% of the loan amount. At November 3, 2007, we owed \$180 million under the unsecured credit facility due fiscal 2012. Refer to Note 4 to the Condensed Consolidated Financial Statements entitled Short-term borrowings and long-term debt.

During the thirty-nine weeks ended November 3, 2007 and October 28, 2006, we sold properties to Vornado Surplus 2006 Realty LLC. Refer to Note 10 to the Condensed Consolidated Financial Statements entitled Net gains on sales of properties .

Equity restructuring

Effective August 3, 2007, management amended the charter of our parent company, Toys R Us Holdings, Inc., by replacing the existing two classes of stock (Class A Common and Class L Common Stock) with a single class of new common stock (the New Common Stock). The New Common Stock does not have a yield accrual, interim distribution, or liquidation preference. Each award outstanding under the previous Management Equity Plan converted

into awards of the

Table of Contents

New Common Stock. The number of shares of the New Common Stock with respect to all such awards is based on the conversion ratios. Each option to acquire shares of the New Common Stock has the same aggregate exercise price as the corresponding option to acquire shares of Class A and Class L Common Stock. The equity restructuring at Toys R Us Holdings, Inc. had no impact on our equity structure or our Condensed Consolidated Financial Statements.

12. Recent accounting pronouncements

In December 2007, the FASB issued SFAS No. 141(R) Business Combinations (SFAS 141(R)). SFAS 141(R) states that all business combinations (whether full, partial or step acquisitions) will result in all assets and liabilities of an acquired business being recorded at their fair values. Certain forms of contingent considerations and certain acquired contingencies will be recorded at fair value at the acquisition date. SFAS 141(R) also states acquisition costs will generally be expensed as incurred and restructuring costs will be expensed in periods after the acquisition date. This statement is effective for financial statements issued for fiscal years beginning after December 15, 2008. We are currently evaluating the impact of SFAS 141(R) on our Condensed Consolidated Financial Statements.

In December 2007, the FASB issued Statement No. 160, Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51 (SFAS 160). SFAS 160 requires a company to clearly identify and present ownership interests in subsidiaries held by parties other than the company in the consolidated financial statements within the equity section but separate from the company's equity. It also requires the amount of consolidated net income attributable to the parent and to the noncontrolling interest be clearly identified and presented on the face of the consolidated statement of income; changes in ownership interest be accounted for similarly, as equity transactions; and when a subsidiary is deconsolidated, any retained noncontrolling equity investment in the former subsidiary and the gain or loss on the deconsolidation of the subsidiary be measured at fair value. This statement is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. We are currently assessing the impact that SFAS 160 will have on our Condensed Consolidated Financial Statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115 (SFAS 159). This statement permits entities to choose to measure eligible items at fair value at specified election dates. The statement requires reporting of unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. The fair value option: (a) may be applied instrument by instrument, with a few exceptions, such as investments otherwise accounted for by the equity method; (b) is irrevocable (unless a new election date occurs); and (c) is applied only to entire instruments and not to portions of instruments. SFAS 159 is effective for fiscal years beginning after November 15, 2007. We are currently assessing the impact that SFAS 159 will have on our Condensed Consolidated Financial Statements.

In September 2006, the FASB issued SFAS No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans (SFAS 158). This statement requires recognition of the funded status of a single-employer defined benefit postretirement plan as an asset or liability in its statement of financial position. Funded status is determined as the difference between the fair value of plan assets and the benefit obligation. Changes in that funded status should be recognized in the year in which the changes occur, in other comprehensive income. This recognition provision and the related disclosures are effective for the Company as of the end of the fiscal year ending after June 15, 2007. The statement also requires the measurement of plan assets and benefit obligations as of the date of the fiscal year-end statement of financial position. This measurement provision is effective for fiscal years ending after December 15, 2008. We are currently assessing the effect that SFAS 158 will have on our Condensed Consolidated Financial Statements.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS 157). SFAS 157, which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007. We are currently assessing the impact that SFAS 157 will have on our Condensed Consolidated Financial Statements.

Table of Contents**13. Restatement of previously issued financial statements**

In the fourth quarter of fiscal 2006, we identified errors in the way we had previously accounted for income taxes. We did not properly record deferred tax accounts on a net basis by legal entity and taxing jurisdiction, as required by SFAS 109. The errors resulted in an overstatement of current and non-current deferred tax assets and liabilities as of October 28, 2006. As a result we have restated the accompanying Condensed Consolidated Balance Sheet. These restatement adjustments did not impact our previously reported interim Condensed Consolidated Statements of Operations, Condensed Consolidated Statements of Cash Flows or Condensed Consolidated Statement of Stockholder's Deficit.

The following table presents the aggregate impact of the errors related to accounting for deferred income taxes on our Consolidated Balance Sheet as of October 28, 2006:

| (In millions) | Previously | | As |
|---|-------------------|--------------------|-------------------------------|
| As of October 28, 2006 | reported | Adjustments | restated⁽¹⁾ |
| Prepaid expenses, derivative assets and other current assets ⁽²⁾ | \$ 315 | \$ (59) | \$ 256 |
| Total current assets | 3,934 | (59) | 3,875 |
| Deferred tax assets | 610 | (478) | 132 |
| Total assets | 9,909 | (537) | 9,372 |
| Accrued expenses and other current liabilities | 834 | (59) | 775 |
| Total current liabilities | 2,910 | (59) | 2,851 |
| Deferred tax liabilities | 507 | (478) | 29 |
| Total liabilities and stockholder's deficit | 9,909 | (537) | 9,372 |

(1) As restated amounts do not include the impact of the adoption of SAB 108. Refer to Note 1 to the Condensed Consolidated Financial Statements entitled Basis of presentation for the combined impact of the restatement and the adoption of SAB 108.

(2) Previously reported as a single line in our Quarterly Report on Form 10-Q Condensed

Consolidated
Balance Sheet.
However, our
current
Condensed
Consolidated
Balance Sheet
as of
October 28,
2006 presents
separately
\$130 million of
Current deferred
tax assets and
\$137 million of
Prepaid
expenses and
other current
assets (which
includes
\$11 million of
assets held for
sale), as restated
and adjusted for
SAB 108.

During the first three quarters of fiscal 2006, we presented certain immaterial other non-product revenue as a reduction in Selling, general and administrative expenses. We have restated Net sales and Selling, general and administrative expenses by increases of \$17 million and \$52 million for the thirteen and thirty-nine weeks ended October 28, 2006, respectively, to correctly present other non-product revenue in Net sales. This resulted in an increase in Net sales and an increase in Selling, general and administrative expenses.

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

The following Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) is intended to help facilitate an understanding of our historical results of operations during the periods presented and our financial condition. This MD&A should be read in conjunction with our Condensed Consolidated Financial Statements and the accompanying notes, and contains forward-looking statements that involve risks and uncertainties. See Forward-Looking Statements below.

Our Business

We generate sales, earnings, and cash flows by retailing toys, baby-juvenile products and children's apparel worldwide. Our reportable segments are Toys R Us U.S. (Toys U.S.), which operates toy stores in 49 states and Puerto Rico and sells merchandise through our Internet sites; Toys R Us International (International), which operates and licenses or franchises stores in 34 foreign countries; and Babies R Us (Babies), which operates specialty baby-juvenile stores in 42 states. As of November 3, 2007, there were 1,553 R Us branded retail stores worldwide.

Restatement of Previously Issued Financial Statements

In the fourth quarter of fiscal 2006, we identified errors in the way we had previously accounted for income taxes. We did not properly record deferred tax accounts on a net basis by legal entity and taxing jurisdiction, as required by Statement of Financial Accounting Standards (SFAS) No. 109 Accounting for Income Taxes (SFAS 109). As a result, we have restated the accompanying Condensed Consolidated Balance Sheet as of October 28, 2006. The restatement adjustments did not impact our previously reported Consolidated Statements of Operations, Consolidated Statements of Cash Flows, or Consolidated Statements of Stockholder's Deficit. Refer to Note 13 to the Condensed Consolidated Financial Statements entitled Restatement of previously issued financial statements for further details.

Adoption of SAB 108

In the fourth quarter of fiscal 2006, we adopted Securities and Exchange Commission (SEC) Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements (SAB 108). As permitted under the transition provisions of SAB 108, in the prior fiscal year, we recorded a cumulative \$(24) million adjustment to opening retained deficit as of January 29, 2006 and adjusted our financial results for the first three quarters of fiscal 2006. These adjustments relate principally to tax-related errors from fiscal years 2005 and 2004 with the balance applicable to years prior to fiscal 2004. We have restated our previously issued financial statement information included in this document. Refer to Note 1 of the Condensed Consolidated Financial Statements entitled Basis of presentation for further details.

Financial Performance

As discussed in more detail in this MD&A, the following financial data presents an overview of our financial performance for the thirteen and thirty-nine weeks ended November 3, 2007 compared to the thirteen and thirty-nine weeks ended October 28, 2006:

| (\$ in millions) | 13 Weeks Ended | | 39 Weeks Ended | |
|---|------------------|------------------|------------------|------------------|
| | November 3, 2007 | October 28, 2006 | November 3, 2007 | October 28, 2006 |
| Net sales growth versus prior year | 9.7% | 16.8% | 8.1% | 14.7% |
| Gross margin as a percentage of Net sales | 35.1% | 34.0% | 35.4% | 34.7% |
| Selling, general and administrative expenses as a percentage of Net sales | 33.2% | 31.6% | 31.8% | 30.9% |
| Net (loss) income | \$ (76) | \$ 41 | \$ (159) | \$ (115) |

Consolidated Net sales for the thirteen and thirty-nine weeks ended November 3, 2007 increased due to comparable store net sales improvements at our International and Babies divisions, increased net sales from new store openings, and benefits in foreign currency translation. Net sales were positively impacted by the shift of our fiscal calendar, which includes early November sales in our fiscal third quarter 2007 results, as compared to fiscal 2006 in which November sales fell into the fourth quarter. The fiscal calendar shift primarily impacted our Toys U.S. and International divisions because of the seasonal nature of the toy industry. Prior year net sales growth for the periods

presented were positively impacted by the consolidation of Toys R Us-Japan Ltd. (Toys-Japan) beginning in the first quarter of 2006.

Table of Contents

Gross margin as a percentage of Net sales for the thirteen and thirty-nine weeks ended November 3, 2007 increased due to improvements in initial markup at all of our divisions, partially offset by increases in markdowns at our Toys U.S. and Babies divisions.

Selling, general and administrative expenses (SG&A) as a percentage of net sales for the thirteen and thirty-nine weeks ended November 3, 2007 increased primarily due to increases in store occupancy and payroll-related expenses as a result of new store openings, as well as increases in corporate-related and advertising expenses.

Net loss for the thirteen and thirty-nine weeks ended November 3, 2007 increased primarily due to increases in SG&A and decreases in Net gains on sales of properties, partially offset by increased Net sales, improvements in Gross margin, and decreases in Interest expense. Net loss for the thirty-nine weeks ended November 3, 2007 was also impacted by decreased Depreciation and amortization expenses.

During the second and third quarters of fiscal 2007, we, along with our vendors, issued recalls for certain products that may not meet or exceed our high safety and quality assurance standards. The direct impact of these recalls has not had a material impact on our results of operations for the thirteen and thirty-nine weeks ended November 3, 2007, since the terms and conditions of our current standard form of purchase order require vendors to reimburse us for all of the costs incurred by us in connection with a recall of such vendor's merchandise. Concerns over recalls may have had, and may continue to have, an indirect impact on consumer demand for toys in general. However, we are unable to specifically quantify any such impact.

Comparable Store Net Sales

We include, in computing comparable store net sales, stores that have been open for 56 weeks (1 year and 4 weeks) from their soft opening date. A soft opening is typically two weeks prior to the grand opening. By measuring the year-over-year sales of merchandise in the stores that have a history of being open for a full comparable 56 weeks or more, we can better gauge how the core store base is performing since it excludes the impact of store openings and closings.

When measuring comparable store net sales, we use sales for the comparable calendar period, regardless of when our fiscal period ends. Therefore, comparable store net sales for fiscal 2007 are calculated by measuring the variances between the thirteen and thirty-nine weeks ended November 3, 2007 with the thirteen and thirty-nine weeks ended November 4, 2006. We feel this is a more accurate reflection of our core businesses.

Various factors affect comparable store net sales, including the number of stores we open or close, the general retail sales environment, consumer preferences and buying trends, changes in sales mix among distribution channels, our ability to efficiently source and distribute products, changes in our merchandise mix, competition, current local and global economic conditions, the timing of our releases of new merchandise and promotional events, the success of marketing programs, and the cannibalization of existing store sales by new stores. Among other things, weather conditions can affect comparable store net sales because inclement weather can require us to close certain stores temporarily and thus reduce store traffic. Even if stores are not closed, many customers may decide to avoid going to stores in bad weather. These factors have caused our comparable store net sales to fluctuate significantly in the past on an annual, quarterly and monthly basis and, as a result, we expect that comparable store net sales will continue to fluctuate in the future.

The percentages, as set forth in the table below, represent changes in comparable store net sales compared to the same periods in the prior year.

| | 13 Weeks Ended | | 39 Weeks Ended | |
|---|---------------------------------|--|---------------------------------|--|
| | November 3, 2007 vs. 2006 | October 28, 2006 vs. 2005 ⁽³⁾ | November 3, 2007 vs. 2006 | October 28, 2006 vs. 2005 ⁽³⁾ |
| Comparable Store Net Sales Performance⁽¹⁾ | | | | |
| Toys R Us U.S. | (2.2)% | 0.4% | 1.2% | (2.3)% |
| Toys R Us International | 2.0% | 5.3% | 3.8% | 2.9% |
| Babies R Us | 1.2% | 6.2% | 2.1% | 5.5% |

(1)

Measures the variances between the thirteen and thirty-nine weeks ended November 3, 2007 and the thirteen and thirty-nine weeks ended November 4, 2006.

- (2) Includes wholly-owned operations. Toys-Japan is considered a wholly-owned operation beginning fiscal 2006. The inclusion of Toys-Japan reduced comparable store net sales for International by 4.5 and 3.8 percentage points for the thirteen and thirty-nine weeks ended November 3, 2007, respectively.
- (3) Comparable store net sales performance for the thirteen and thirty-nine weeks ended October 28, 2006, as compared to the same periods in fiscal 2005, excludes the

operations of
Toys-Japan,
whose results
we began
consolidating in
fiscal 2006.

Table of Contents**Store Count by Division (Segment)**

| | Divisional Store Count | | |
|-------------------------|---------------------------------|---------------------------------|---------------|
| | November 3, 2007 | October 28, 2006 | Change |
| Toys R Us U.S. | 587 | 587 | |
| Toys R Us International | 709 | 662 | 47 |
| Babies R Us | 257 | 245 | 12 |
| Total | 1,553 | 1,494 | 59 |

- (1) Store count as of November 3, 2007 includes 502 wholly-owned (including 169 in Japan) and 207 licensed and franchised stores. Store count as of October 28, 2006 includes 478 wholly-owned (including 164 in Japan) and 184 licensed and franchised stores.

Net (Loss) Income

| | 13 Weeks Ended | | | 39 Weeks Ended | | |
|----------------------|---------------------------------|---------------------------------|-----------------|---------------------------------|---------------------------------|----------------|
| | November 3, 2007 | October 28, 2006 | Change | November 3, 2007 | October 28, 2006 | Change |
| (In millions) | | | \$ | | | \$ |
| Net (loss) income | \$ (76) | \$ 41 | \$ (117) | \$ (159) | \$ (115) | \$ (44) |

Net income decreased by \$117 million to a loss for the thirteen weeks ended November 3, 2007, compared to the same period last year. The decrease was primarily due to increases in SG&A of \$122 million as a result of increases in corporate-related, store occupancy, payroll-related, and advertising expenses, a decrease in net gains on sales of properties of \$91 million, and a decrease in income tax benefit of \$13 million. Partially offsetting the decreases was an increase in our gross margin of \$116 million as a result of increased overall net sales.

Net loss increased by \$44 million for the thirty-nine weeks ended November 3, 2007, compared to the same period last year. The net loss increased primarily due to increases in SG&A of \$256 million primarily as a result of increases in payroll-related, store occupancy, corporate-related, and advertising expenses, and a decrease in net gains on sales of

properties of \$75 million, and a decrease in income tax benefit of \$13 million. Partially offsetting these increases to our net loss was an increase in our gross margin of \$264 million as a result of increased overall net sales; a decrease in interest expense of \$23 million primarily due to reduced borrowings and lower amortization of deferred financing costs in fiscal 2007; and a decrease in depreciation and amortization expense of \$14 million primarily due to accelerated depreciation related to the fiscal 2005 restructuring initiative recorded in the first quarter of fiscal 2006.

Net Sales

During the second and third quarters of fiscal 2007, we, along with our vendors, issued recalls for certain products that may not meet or exceed our high safety and quality assurance standards. The direct impact of these recalls has not had a material impact on our results of operations for the thirteen and thirty-nine weeks ended November 3, 2007, since the terms and conditions of our current standard form of purchase order require vendors to reimburse us for all of the costs incurred by us in connection with a recall of such vendor's merchandise. Concerns over recalls may have had, and may continue to have, an indirect impact on consumer demand for toys in general. However, we are unable to specifically quantify any such impact.

Table of Contents**13 Weeks Ended**

| | | | | | Percentage of Net Sales | |
|---------------------------|----------------|----------------|--------------|-------------|-------------------------|----------------|
| | November 3, | October 28, | | | November 3, | October 28, |
| (\$ in millions) | 2007 | 2006 | \$ Change | % Change | 2007 | 2006 |
| Toys R Us - U.S. | \$ 1,040 | \$ 986 | \$ 54 | 5.5% | 37.4% | 38.9% |
| Toys R Us - International | 1,107 | 948 | 159 | 16.8% | 39.8% | 37.4% |
| Babies R Us | 634 | 600 | 34 | 5.7% | 22.8% | 23.7% |
| Total net sales | \$ 2,781 | \$ 2,534 | \$ 247 | 9.7% | 100.0% | 100.0% |

For the thirteen weeks ended November 3, 2007, net sales increased by \$247 million, or 9.7%, to \$2.8 billion from \$2.5 billion for the same period last year. Net sales for the thirteen weeks ended November 3, 2007 included the impact of foreign currency translation that increased net sales by \$71 million.

The increase in net sales for thirteen weeks ended November 3, 2007, excluding foreign currency translation, was primarily the result of net sales increases at all of our divisions compared to the same period last year. These increases were primarily related to new store openings at our International and Babies divisions, increases in our internet-based net sales, and improved comparable store net sales. Reported results also improved due to the one-week shift of our fiscal 2007 calendar, which primarily impacted our Toys U.S. and International divisions and represented approximately \$80 million of the increase in net sales.

39 Weeks Ended

| | | | | | Percentage of Net Sales | |
|---------------------------|----------------|----------------|--------------|-------------|-------------------------|----------------|
| | November 3, | October 28, | | | November 3, | October 28, |
| (\$ in millions) | 2007 | 2006 | \$ Change | % Change | 2007 | 2006 |
| Toys R Us - U.S. | \$ 3,058 | \$ 2,981 | \$ 77 | 2.6% | 38.4% | 40.4% |
| Toys R Us - International | 3,013 | 2,630 | 383 | 14.6% | 37.8% | 35.7% |
| Babies R Us | 1,896 | 1,760 | 136 | 7.7% | 23.8% | 23.9% |
| Total net sales | \$ 7,967 | \$ 7,371 | \$ 596 | 8.1% | 100.0% | 100.0% |

For the thirty-nine weeks ended November 3, 2007, net sales increased by \$596 million, or 8.1%, to \$8.0 billion from \$7.4 billion for the same period last year. Net sales for the thirty-nine weeks ended November 3, 2007 included the impact of foreign currency translation that increased net sales by \$135 million.

The increase in net sales for thirty-nine weeks ended November 3, 2007, excluding foreign currency translation, was primarily the result of net sales increases in our International and Babies divisions compared to the same period last year related to new store openings at our International and Babies divisions, improved comparable store net sales, and increases in our internet-based net sales. Reported results also improved due to the one-week shift of our fiscal 2007 calendar, which primarily impacted our Toys U.S. and International divisions and accounted for approximately \$94 million of the increase in net sales, and also increases in our internet-based net sales.

Toys R Us U.S.

Net sales for the Toys U.S. division increased by \$54 million, or 5.5%, to \$1,040 million for the thirteen weeks ended November 3, 2007 compared to \$986 million in the same period last year. The increase in net sales was primarily a result of the one-week shift in the current year's quarter end, which represented approximately \$53 million of the increase in net sales, and increases in our internet-based net sales, partially offset by a decrease in comparable store

net sales.

The comparable store net sales decrease was primarily due to lower sales in our learning, core toys, juvenile and seasonal categories, which were primarily impacted by changes in product assortments. These decreases were partially offset by strong demand for the Nintendo Wii video game system and related accessories in the entertainment category.

Net sales for the Toys U.S. division increased by \$77 million, or 2.6%, to \$3,058 million for the thirty-nine weeks ended November 3, 2007 compared to \$2,981 million in the same period last year. The increase in net sales was primarily a result of the one-week shift in the current year's quarter end, which represented approximately \$54 million of the increase in net sales, increases in our internet-based net sales, and an increase in comparable store net sales. These increases were partially offset by decreased net sales as a result of the closing of 84 stores during the first quarter of 2006.

Table of Contents

The comparable store net sales increase was primarily a result of an increase in our entertainment category as a result of strong demand for the Nintendo Wii video game system and related accessories. These increases were partially offset by lower sales in our juvenile category, which was primarily impacted by a change in product assortments, along with lower sales in our learning and core toys categories, primarily due to a decline in sales of older product lines.

Toys R Us International

Net sales for the International division increased by \$159 million, or 16.8%, to \$1,107 million for the thirteen weeks ended November 3, 2007, compared to \$948 million in the same period last year. Excluding a \$71 million increase in net sales due to foreign currency translation, net sales of our International division increased primarily due to new store openings, an increase in comparable store net sales, and the one-week shift in the current year's quarter end, which represented approximately \$25 million of the increase in net sales.

The comparable store net sales increase was primarily a result of increases in our entertainment, infant care and core toys categories. The entertainment category increased due to continued strong demand for the Nintendo Wii and Sony PlayStation 3 video game systems and related accessories. The increase in the infant care category was primarily due to increased infant consumables, bedding and furniture. The core toys category increased primarily due to higher sales of licensed action figures.

Net sales for the International division increased by \$383 million, or 14.6%, to \$3,013 million for the thirty-nine weeks ended November 3, 2007, compared to \$2,630 million in the same period last year. Excluding a \$135 million increase in net sales due to foreign currency translation, net sales of our International division increased primarily due to new store openings, an increase in comparable store net sales, and the one-week shift in the current year's quarter end, which represented approximately \$42 million of the increase in net sales.

The comparable store net sales increase was primarily impacted by increases in our entertainment, infant care and core toys categories. The entertainment category increased due to continued strong demand for the Nintendo Wii and Sony PlayStation 3 video game systems and related accessories. The increase in the infant care category was primarily due to increased infant consumables, bedding and furniture. The core toys category increased primarily due to higher sales of licensed action figures. These increases were partially offset by decreases in our seasonal category due to decreased demand for outdoor products and bicycles.

Babies R Us

Net sales for the Babies division increased by \$34 million, or 5.7%, to \$634 million, for the thirteen weeks ended November 3, 2007, compared to \$600 million in the same period last year. The increase was primarily a result of net sales from new store openings, as well as an increase in comparable store net sales.

The comparable store net sales increase was primarily a result of increases in our commodities and infant care categories. The commodities category was positively impacted by continued strong trends in diapers and wipes, new feature space dedicated to baby food and other new products. The infant care category increased primarily due to safety products, monitors and infant feeding products. These increases were partially offset by lower sales in the furniture and apparel categories.

Net sales for the Babies division increased by \$136 million, or 7.7%, to \$1,896 million, for the thirty-nine weeks ended November 3, 2007, compared to \$1,760 million in the same period last year. The increase was primarily a result of net sales from new store openings, as well as an increase in comparable store net sales.

The comparable store net sales increase was primarily a result of increases in our commodities and infant care categories. The commodities category increased primarily due to continued strong demand for baby foods, and value-packaged products. The infant care category increased primarily due to strong demand for safety products, monitors and infant feeding products. Increases in these categories were partially offset by lower sales in the furniture category.

Cost of Sales and Gross Margin

The following costs are included in Cost of sales and Gross margin:

The cost of acquired merchandise from vendors;

Freight in;

Markdowns;

Provision for inventory shortages; and

25

Table of Contents

Credits and allowances from our merchandise vendors.

| (\$ in millions) | 13 Weeks Ended | | | | | |
|---------------------------|------------------------|------------------------|--------------|-------------------------|------------------------|---|
| | | | | Percentage of Net Sales | | |
| | November 3, 2007 | October 28, 2006 | \$ Change | November 3, 2007 | October 28, 2006 | Percentage of Net Sales Change |
| Toys R Us - U.S. | \$ 314 | \$ 294 | \$ 20 | 30.2% | 29.8% | 0.4% |
| Toys R Us - International | 407 | 330 | 77 | 36.8% | 34.8% | 2.0% |
| Babies R Us | 256 | 237 | 19 | 40.4% | 39.5% | 0.9% |
| Total gross margin | \$ 977 | \$ 861 | \$ 116 | 35.1% | 34.0% | 1.1% |

Gross margin increased by \$116 million to \$977 million for the thirteen weeks ended November 3, 2007, compared to \$861 million in the same period last year. Gross margin, as a percentage of net sales, increased by 1.1 percentage points for the thirteen weeks ended November 3, 2007, compared to the same period last year. Gross margin as a percentage of net sales was positively impacted by improvements in initial markup at all of our divisions, partially offset by increased markdowns at our Toys U.S. and Babies divisions.

| (\$ in millions) | 39 Weeks Ended | | | | | |
|---------------------------|------------------------|------------------------|--------------|-------------------------|------------------------|---|
| | | | | Percentage of Net Sales | | |
| | November 3, 2007 | October 28, 2006 | \$ Change | November 3, 2007 | October 28, 2006 | Percentage of Net Sales Change |
| Toys R Us - U.S. | \$ 988 | \$ 955 | \$ 33 | 32.3% | 32.0% | 0.3% |
| Toys R Us - International | 1,086 | 926 | 160 | 36.0% | 35.2% | 0.8% |
| Babies R Us | 748 | 677 | 71 | 39.5% | 38.5% | 1.0% |
| Total gross margin | \$ 2,822 | \$ 2,558 | \$ 264 | 35.4% | 34.7% | 0.7% |

Gross margin increased by \$264 million to \$2,822 million for the thirty-nine weeks ended November 3, 2007, compared to \$2,558 million in the same period last year. Gross margin, as a percentage of net sales, increased by 0.7 percentage points for the thirty-nine weeks ended November 3, 2007, compared to the same period last year. Gross margin as a percentage of net sales was positively impacted by improvements in initial markup at all of our divisions, partially offset by increased markdowns at our Toys U.S. and Babies divisions.

Toys R Us U.S.

Gross margin increased by \$20 million to \$314 million for the thirteen weeks ended November 3, 2007, compared to \$294 million in the same period last year. Gross margin, as a percentage of net sales, for the thirteen weeks ended November 3, 2007 increased 0.4 percentage points compared to the same period last year. The increase in gross margin as a percentage of net sales was primarily due to improved initial markup, which contributed a 1.1 percentage point increase, partially offset by increased markdowns, which contributed a 0.7 percentage point decrease.

Gross margin increased by \$33 million to \$988 million for the thirty-nine weeks ended November 3, 2007, compared to \$955 million in the same period last year. Gross margin, as a percentage of net sales, for the thirty-nine weeks ended November 3, 2007 increased 0.3 percentage points compared to the same period last year. The increase in gross margin as a percentage of net sales was primarily due to improved initial markup, which contributed a 1.2 percentage point increase, partially offset by increased markdowns, which contributed a 0.9 percentage point decrease.

The improved initial markup was primarily a result of increased sales of private label products. The increase in markdown costs was the result of planned increases in promotional events and clearance markdowns taken to keep inventory current.

Toys R Us International

Gross margin increased by \$77 million to \$407 million for the thirteen weeks ended November 3, 2007, compared to \$330 million in the same period last year. Gross margin, as a percentage of net sales, for the thirteen weeks ended November 3, 2007 increased 2.0 percentage points.

Table of Contents

The increase in gross margin as a percentage of net sales was primarily a result of improved initial markup in certain markets due to favorable changes in our sales mix toward higher margin products such as juvenile furniture in our infant care category and licensed products in our core toy category. Our change in accounting method for valuing merchandise inventories of our international wholly-owned subsidiaries from the retail inventory method to the weighted average cost method (see Note 3 to the Condensed Consolidated Financial Statements entitled "Change in accounting principle") had no material effect on our gross margin for the thirteen weeks ended November 3, 2007. Gross margin increased by \$160 million to \$1,086 million for the thirty-nine weeks ended November 3, 2007, compared to \$926 million in the same period last year. Gross margin, as a percentage of net sales, for the thirty-nine weeks ended November 3, 2007 increased 0.8 percentage points.

The increase in gross margin as a percentage of net sales was primarily a result of improved initial markup in certain markets due to favorable changes in our sales mix toward higher margin products such as juvenile furniture and apparel in our infant care category and licensed products in our core toy category. Additionally, our change in accounting method for valuing merchandise inventories of our international wholly-owned subsidiaries from the retail inventory method to the weighted average cost method (see Note 3 to the Condensed Consolidated Financial Statements entitled "Change in accounting principle") contributed an approximate \$11 million increase to our gross margin for the thirty-nine weeks ended November 3, 2007.

Babies R Us

Gross margin increased by \$19 million to \$256 million for the thirteen weeks ended November 3, 2007 compared to \$237 million for the same period last year. Gross margin, as a percentage of net sales, increased 0.9 percentage points compared to the same period last year. The increase in gross margin as a percentage of net sales was primarily due to improved initial markup, which contributed a 1.9 percentage point increase, partially offset by increased markdowns, which contributed a 1.0 percentage point decrease.

Gross margin increased by \$71 million to \$748 million for the thirty-nine weeks ended November 3, 2007 compared to \$677 million for the same period last year. Gross margin, as a percentage of net sales, increased 1.0 percentage point compared to the same period last year. The increase in gross margin as a percentage of net sales was primarily due to an increase in initial markup, which contributed a 1.9 percentage point increase, partially offset by increased markdowns, which contributed a 0.9 percentage point decrease.

The improved initial markup was primarily a result of a favorable change in our sales mix toward higher margin products in the infant care category. This increase in gross margin percentage was partially offset by additional markdowns to keep inventory current, as well as markdowns from additional marketing events.

Selling, General and Administrative Expenses (SG&A)

The following costs are included in SG&A:

Store payroll and related payroll benefits;

Rent and other store operating expenses;

Advertising expenses;

Other income;

Costs associated with operating our distribution network that primarily relate to moving merchandise from distribution centers to stores; and

Other corporate-related expenses.

Table of Contents

| (\$ in millions) | 13 Weeks Ended | | | | | |
|--------------------------|------------------|------------------|-----------|-------------------------|------------------|--------------------------------|
| | | | | Percentage of Net Sales | | |
| | November 3, 2007 | October 28, 2006 | \$ Change | November 3, 2007 | October 28, 2006 | Percentage of Net Sales Change |
| Toys R Us - Consolidated | \$ 924 | \$ 802 | \$ 122 | 33.2% | 31.6% | 1.6% |

SG&A expenses increased \$122 million to \$924 million, for the thirteen weeks ended November 3, 2007, compared to \$802 million for the same period last year. As a percentage of net sales, SG&A expenses increased 1.6 percentage points. SG&A expenses for the thirteen weeks ended November 3, 2007 included the impact of foreign currency translation that increased SG&A by approximately \$22 million.

In addition to the impact of foreign currency translation, the increase in SG&A expenses was primarily due to increases in corporate-related, store occupancy, payroll-related, and advertising expenses. Corporate-related expenses increased primarily due to higher professional fees, as well as the filling of higher-level positions at our Corporate division. Store occupancy and payroll-related expenses increased primarily due to new store openings at our International and Babies divisions, increased costs to improve store layouts at our Toys U.S. division, and higher store staffing at our Toys U.S. and International divisions to support increased sales and training initiatives. Advertising expenses increased due to increases in print advertising and promotional activities at all of our divisions.

| (\$ in millions) | 39 Weeks Ended | | | | | |
|--------------------------|------------------|------------------|-----------|-------------------------|------------------|--------------------------------|
| | | | | Percentage of Net Sales | | |
| | November 3, 2007 | October 28, 2006 | \$ Change | November 3, 2007 | October 28, 2006 | Percentage of Net Sales Change |
| Toys R Us - Consolidated | \$ 2,536 | \$ 2,280 | \$ 256 | 31.8% | 30.9% | 0.9% |

SG&A expenses increased \$256 million to \$2.5 billion, for the thirty-nine weeks ended November 3, 2007, compared to \$2.3 billion for the same period last year. As a percentage of net sales, SG&A expenses increased 0.9 percentage points. SG&A expenses for the thirty-nine weeks ended November 3, 2007 included the impact of foreign currency translation that increased SG&A by approximately \$47 million.

In addition to the impact of foreign currency translation, the increase in SG&A expenses was primarily due to increases in payroll-related, store occupancy, corporate-related, and advertising expenses. Payroll-related and store occupancy expenses increased primarily due to new store openings at our International and Babies divisions, along with increased costs at our Toys U.S. division due to higher store staffing expenditures, and increased costs to improve store layouts. Corporate-related expenses increased primarily due to higher professional fees, as well as the filling of higher-level positions at our Corporate division. Advertising expenses increased due to increases in print advertising and promotional activities at all of our divisions.

Depreciation and Amortization

| (In millions) | 13 Weeks Ended | | | 39 Weeks Ended | | |
|---------------|--------------------------|------------------|-----------|------------------|------------------|-----------|
| | November 3, 2007 | October 28, 2006 | \$ Change | November 3, 2007 | October 28, 2006 | \$ Change |
| | Toys R Us - Consolidated | \$ 94 | \$ 92 | \$ 2 | \$ 291 | \$ 305 |

Depreciation and amortization increased by \$2 million, or 2.2%, to \$94 million for the thirteen weeks ended November 3, 2007, compared to the same period last year.

Depreciation and amortization decreased by \$14 million, or 4.6%, to \$291 million for the thirty-nine weeks ended November 3, 2007, compared to the same period last year. The decrease was primarily attributed to \$24 million of accelerated depreciation related to the fiscal 2005 restructuring initiative recorded in the first quarter of fiscal 2006, partially offset by higher depreciation expense at Babies and International due to stores opened since October 28, 2006.

Table of Contents**Net gains on sales of properties**

| | 13 Weeks Ended | | | 39 Weeks Ended | | |
|--------------------------|----------------|----------------|---------|----------------|----------------|---------|
| | November 3, | October 28, | \$ | November 3, | October 28, | \$ |
| (In millions) | 2007 | 2006 | Change | 2007 | 2006 | Change |
| Toys R Us - Consolidated | \$ 18 | \$ 109 | \$ (91) | \$ 34 | \$ 109 | \$ (75) |

Net gains on sales of properties decreased by \$91 million and \$75 million for the thirteen and thirty-nine weeks ended November 3, 2007, respectively, compared to the same period last year. This decrease was primarily due to the gains of \$109 million in the third quarter of fiscal 2006 primarily related to the sale of 38 stores to Vornado Surplus 2006 Realty LLC.

Refer to Note 10 to the Condensed Consolidated Financial Statements entitled Net gains on sales of properties for further details.

Restructuring Charges (Reversals) and Other

| | 13 Weeks Ended | | | 39 Weeks Ended | | |
|--------------------------|----------------|----------------|--------|----------------|----------------|--------|
| | November 3, | October 28, | \$ | November 3, | October 28, | \$ |
| (In millions) | 2007 | 2006 | Change | 2007 | 2006 | Change |
| Toys R Us - Consolidated | \$ 3 | \$ (1) | \$ 4 | \$ 4 | \$ 4 | \$ |

During the thirteen weeks ended November 3, 2007, we recorded charges of \$3 million based on changes in estimated lease commitments. During the thirteen weeks ended October 28, 2006, we recorded charges of \$3 million for changes in estimated lease commitments and disposal charges, which were offset by the reversal of \$4 million of reserves primarily for previously recorded lease commitments on properties sold during the third quarter of 2006.

During the thirty-nine weeks ended November 3, 2007, we recorded charges of \$7 million and reversed \$3 million of previously recorded reserves based on changes in estimated lease commitments. For the thirty-nine weeks ended October 28, 2006, we incurred \$10 million of charges relating to lease commitments and disposal charges, which were partially offset by the reversal of \$6 million of previously recorded reserves primarily related to lease commitments and severance.

Restructuring charges (reversals) related to prior years initiatives are primarily due to changes in management's estimates for events such as lease terminations, assignments and sublease income adjustments. Refer to Note 2 to the Condensed Consolidated Financial Statements entitled Restructuring and other charges for further details.

Interest Expense

| | 13 Weeks Ended | | | 39 Weeks Ended | | |
|--------------------------|----------------|----------------|--------|----------------|----------------|--------|
| | November 3, | October 28, | \$ | November 3, | October 28, | \$ |
| (In millions) | 2007 | 2006 | Change | 2007 | 2006 | Change |
| Toys R Us - Consolidated | \$ (136) | \$ (141) | \$ 5 | \$ (378) | \$ (401) | \$ 23 |

Interest expense decreased \$5 million and \$23 million for the thirteen and thirty-nine weeks ended November 3, 2007, respectively, compared to the same periods last year, primarily due to reduced borrowings and reduced amortization of deferred financing costs in fiscal 2007, which decreased Interest expense by approximately \$15 million and \$44 million for the thirteen and thirty-nine weeks ended November 3, 2007, respectively, compared to the same periods last year. These decreases were partially offset by charges related to changes in the fair values of our derivatives which do not qualify for hedge accounting, which increased Interest expense by approximately \$10 million

and \$21 million for the thirteen and thirty-nine weeks ended November 3, 2007, respectively, compared to the same periods last year.

Table of Contents**Interest Income**

| | 13 Weeks Ended | | | 39 Weeks Ended | | |
|--------------------------|------------------------|------------------------|--------------|------------------------|------------------------|--------------|
| | November 3, 2007 | October 28, 2006 | \$ Change | November 3, 2007 | October 28, 2006 | \$ Change |
| (In millions) | | | | | | |
| Toys R Us - Consolidated | \$ 3 | \$ 4 | \$ (1) | \$ 15 | \$ 17 | \$ (2) |

Interest income decreased slightly for the thirteen and thirty-nine weeks ended November 3, 2007 compared to the same periods last year, primarily due to more efficient global cash management.

Income tax benefit

The following table summarizes our income tax benefit and effective tax rates for the thirteen and thirty-nine weeks ended November 3, 2007 and October 28, 2006:

| | 13 Weeks Ended | | 39 Weeks Ended | |
|--|------------------------|---------------------|------------------------|---------------------|
| | November 3, 2007 | October 28, 2006 | November 3, 2007 | October 28, 2006 |
| Loss before income taxes and minority interest | \$ (159) | \$ (60) | \$ (338) | \$ (306) |
| Income tax benefit | 81 | 94 | 170 | 183 |
| Effective tax rate | (50.9)% | (156.7)% | (50.3)% | (59.8)% |

The effective tax rates for the thirteen and thirty-nine weeks ended November 3, 2007 and October 28, 2006, respectively, were based primarily on our forecasted annualized effective tax rates, adjusted for discrete items that occurred within the periods presented. Our forecasted annualized effective tax rate was 50.3% compared to 34.5% in the same period last year. The difference between our forecasted annualized effective tax rates was primarily due to our current year determination to deduct rather than claim credits for foreign taxes.

For the thirteen weeks ended November 3, 2007, our effective tax rate was impacted primarily by additional income tax benefit resulting from the reversal of valuation allowance of \$10 million related to foreign tax credits. The additional income tax benefit was partially offset by income tax expense of \$3 million from adjustments to our FIN 48 liability and our current taxes payable. For the thirteen weeks ended October 28, 2006, our effective tax rate was impacted by additional income tax benefits primarily related to the reversal of valuation allowance of \$80 million. The income tax benefits were partially offset by income tax expense of \$10 million related to adjustments in certain estimated tax reserves and non-deductible officer compensation.

For the thirty-nine weeks ended November 3, 2007, our effective tax rate was primarily impacted by additional income tax benefits of \$11 million related to the reversal of valuation allowance and changes in tax laws. The additional income tax benefits were partially offset by income tax expense of \$8 million related to adjustments to our FIN 48 liability, adjustments to our current income taxes payable, and settlements of certain tax audits. For the thirty-nine weeks ended October 28, 2006, our effective tax rate was impacted by additional income tax benefits primarily related to the reversal of valuation allowance of \$86 million. The income tax benefits were offset by income tax expense of \$8 million related to adjustments in certain estimated tax reserves, non-deductible officer compensation, and changes in state tax laws.

Liquidity and Capital Resources**Overview**

At November 3, 2007, under our \$2 billion secured revolving credit facility, we had \$489 million in borrowings outstanding, \$125 million of outstanding letters of credit, and remaining availability of \$1,380 million. In addition, under our multi-currency revolving credit facilities, we had \$28 million in borrowings outstanding and \$380 million of remaining availability. We have classified borrowings under these revolving credit facilities as long-term, as the revolving credit facilities expire in fiscal 2010. However, we may pay these facilities down within the next twelve months if we have the ability to do so either through additional long-term financing or through cash from operating

activities. As part of our normal course of business, we are continuously evaluating opportunities that will allow us to reduce the costs related to our borrowings.

In general, our primary uses of cash are debt servicing, financing construction of new stores and remodeling existing stores, providing for working capital, which principally represents the purchase of inventory, and paying expenses to operate our

Table of Contents

stores. We will consider additional sources of financing to fund our long-term growth. Our working capital needs follow a seasonal pattern, peaking in the third quarter of the year when inventory is received for the holiday selling season. Our largest source of operating cash flows is cash collections from our customers. We have been able to meet our cash needs principally by using cash on hand, cash flows from operations, our variable rate revolving credit facilities and the multi-currency revolving credit facilities.

We believe that cash generated from operations, along with our existing cash and revolving credit facilities, will be sufficient to fund our expected cash flow requirements and planned capital expenditures for at least the next twelve months.

| | 39 Weeks Ended | | | |
|--|---------------------------------|---------------------------------|----------------------|---------------------|
| | November 3, 2007 | October 28, 2006 | \$ Change | % Change |
| (\$ in millions) | | | | |
| Net cash used in operating activities | \$ (946) | \$ (1,238) | \$ 292 | 23.6% |
| Net cash (used in) provided by investing activities | (140) | 3 | (143) | (4,766.7)% |
| Net cash provided by financing activities | 513 | 609 | (96) | (15.8)% |
| Effect of exchange rate changes on cash and cash equivalents | 48 | 38 | 10 | 26.3% |
| Net decrease during period in cash and cash equivalents | \$ (525) | \$ (588) | \$ 63 | 10.7% |

Cash Flows Used in Operating Activities

During the thirty-nine weeks ended November 3, 2007, net cash used in operating activities was \$946 million compared to \$1,238 million during the thirty-nine weeks ended October 28, 2006. The \$292 million decrease in net cash used in operating activities was primarily the result of changes in accounts payable due to extended payment terms from vendors, and lower interest payments resulting from lower average debt balances. These decreases were partially offset by increased spending on merchandise inventories for new and existing stores.

Cash Flows (Used in) Provided by Investing Activities

During the thirty-nine weeks ended November 3, 2007, net cash used in investing activities was \$140 million compared to \$3 million provided by investing activities for the thirty-nine weeks ended October 28, 2006. The \$143 million increase in net cash used in investing activities was primarily due to a \$161 million decrease in cash inflows from the sale of fixed assets and a \$48 million increase in capital expenditures. The increase in net cash used in investing activities was partially offset by a \$66 million increase in cash flows resulting from a \$22 million release of previously restricted cash in the thirty-nine weeks ended November 3, 2007 compared to a \$44 million increase in restricted cash related to property financings in the thirty-nine weeks ended October 28, 2006.

Our capital expenditures are primarily for financing construction of new stores and remodeling existing stores. In addition, our capital expenditures include costs to improve and enhance our information technology systems. For the remainder of the fiscal year, we plan to continue to increase our capital spend compared to the prior year as we focus on the turnaround of the Toys U.S. division, and our investments in our International and Babies divisions.

Cash Flows Provided by Financing Activities

During the thirty-nine weeks ended November 3, 2007, net cash provided by financing activities was \$513 million compared to \$609 million for the thirty-nine weeks ended October 28, 2006. The \$96 million decrease in net cash provided by financing activities was primarily due to a \$2,468 million reduction in borrowings, partially offset by a \$2,326 million decrease in repayments. The decrease in gross borrowings and repayments reflects a reduction in refinancing activities compared to prior year. The net decrease in borrowings is primarily due to lower borrowings on our revolving credit facilities in the current year due to improved cash flows from operating activities, partially offset by lower cash proceeds from sales of fixed assets.

Debt

During the thirty-nine weeks ended November 3, 2007, we made the following changes to our debt structure: On February 8, 2007, Toys R Us Properties (UK) Limited borrowed an additional \$4 million from the Junior Lender of our U.K. Real Estate Credit Facility under conditions previously specified in the original loan agreement dated February 8, 2006.

Table of Contents

On July 9, 2007, we notified the lenders for our \$800 million secured real estate loan that we were exercising our first maturity date extension option (the First Extension Option), which extended the maturity date of the loan from August 9, 2007 to August 9, 2008. The other key terms of the loan were not changed as a result of the extension. We have the ability and intent to exercise our two remaining maturity date extension options to August 2009 and August 2010.

On June 1, 2007, Toys-Delaware repaid \$9 million of principal of the \$200 million asset sale facility with proceeds from the properties sold in the second quarter of fiscal 2007. On August 23, 2007, Toys-Delaware repaid an additional \$10 million of principal with proceeds from the lease termination agreement consummated during the second quarter of fiscal 2007. On November 2, 2007, Toys-Delaware repaid the remaining \$25 million outstanding principal balance with a portion of the \$29 million proceeds from the property sold during the third quarter of fiscal 2007. Refer to Note 10 to the Condensed Consolidated Financial Statements entitled Net gains on sales of properties for additional information on each transaction. As of November 3, 2007, we had fully repaid the \$200 million asset sale facility. On November 2, 2007, Toys-Delaware used the remaining \$4 million of the \$29 million proceeds from property sold during the third quarter of fiscal 2007 (refer to Note 10 to the Condensed Consolidated Financial Statements entitled Net gains on sales of properties) to repay a portion of the secured term loan facility, leaving an outstanding balance of \$797 million.

Contractual Obligations and Commitments

There have been no significant changes to our contractual obligations and commercial commitments table as disclosed in our Annual Report on Form 10-K for the fifty-three weeks ended February 3, 2007, except for a change related to our adoption of FIN 48. The short-term and long-term net liabilities for uncertain tax positions under FIN 48 were \$40 million and \$108 million, respectively, as of February 4, 2007. During the thirty-nine weeks ended November 3, 2007, the total unrecognized tax benefits did not change materially (refer to Note 6 to the Condensed Consolidated Financial Statements entitled Income taxes). At this time, we are not able to reasonably estimate when cash payments of the long-term liability for uncertain tax positions will occur.

Refer to the CONTRACTUAL OBLIGATIONS section of the Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the fiscal year ended February 3, 2007, for details on our contractual obligations and commitments.

Credit Ratings

As of November 2, 2007, our credit ratings, which are considered non-investment grade, were as follows:

| | Moody's | Standard and Poor's |
|----------------|----------------|----------------------------|
| Long-term debt | B2 | B |
| Outlook | Stable | Stable |

On August 24, 2007, Moody's confirmed our B2 rating and upgraded the outlook to Stable after having previously changed the outlook to Review for possible downgrade as a result of our filing an extension for our Annual Report in Form 10-K. Moody's stated that the Stable outlook is a result of the significant progress the Company has made in improving its business and reducing financial leverage.

On June 29, 2007, Standard and Poor's upgraded our corporate credit rating from B- with a Positive outlook to B with a Stable outlook. Prior to this rating, the Company had been placed on CreditWatch with positive implications, as a result of the filing of our Annual Report in Form 10-K. The latest rating change was based on improved operating performance and credit protection metrics.

Other credit ratings for our debt are available; however, we have disclosed only the ratings of the two largest nationally recognized statistical rating organizations.

Our current credit ratings, as well as any adverse future actions taken by the rating agencies with respect to our debt ratings, could (1) negatively impact our ability to finance our operations on satisfactory terms and (2) have the effect of increasing our financing costs. Our debt instruments do not contain provisions requiring acceleration of payment upon a debt rating downgrade.

Table of Contents

The rating agencies may, in the future, revise the ratings in respect of our outstanding debt.

Critical Accounting Policies

Our condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make certain estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and the related disclosures of contingent assets and liabilities as of the date of the financial statements and during the applicable periods. We base these estimates on historical experience and on other factors that we believe are reasonable under the circumstances. Actual results may differ materially from these estimates under different assumptions or conditions and could have a material impact on our Condensed Consolidated Financial Statements.

Merchandise inventories

On February 4, 2007, we changed our accounting method for valuing our international wholly-owned subsidiaries merchandise inventories from the retail inventory method to the weighted average cost method. This change in accounting principle was a result of implementing a perpetual inventory system in our international locations that allows management to track our inventory costs at a product level. We have accounted for the change in accounting principle in accordance with SFAS No.154, Accounting Changes and Error Corrections a replacement of APB Opinion No. 20 and FASB Statement No. 3 (SFAS 154). Refer to Note 3 to the Condensed Consolidated Financial Statements entitled Change in accounting principles for the impact on our Condensed Consolidated Financial Statements and further details.

As previously described in our fiscal 2006 Annual Report on Form 10-K, merchandise inventories for the Toys U.S. division, other than apparel, are stated at the lower of LIFO (last-in, first-out) cost or market value, as determined by the retail inventory method. The excess of replacement or current cost over stated LIFO value is immaterial. All other merchandise inventories for our domestic subsidiaries are stated at the lower of FIFO (first-in, first-out) cost or market value as determined by the retail inventory method. As of November 3, 2007, February 3, 2007 and October 28, 2006, approximately 38%, 10% and 9%, respectively, of merchandise inventories were valued under the weighted average cost method.

Income taxes

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48 (As amended) Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN 48). This interpretation clarifies the accounting for uncertainty in income taxes recognized in the financial statements in accordance with SFAS No. 109, Accounting for Income Taxes (SFAS 109) and prescribes a recognition threshold and measurement attributes for financial statement disclosure of tax positions taken or expected to be taken on a tax return. FIN 48 provides that a tax benefit from an uncertain tax position may be recognized when it is more likely than not that the position will be sustained upon examination, based on the technical merits. This interpretation provides guidance on measurement, derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. As of February 4, 2007, we adopted the provisions in FIN 48. Refer to Note 6 to the Condensed Consolidated Financial Statements entitled Income taxes for the impact on our Condensed Consolidated Financial Statements and further discussion related to the adoption of FIN 48.

A summary of other significant accounting policies and a description of accounting policies that we believe are critical may be found in our Annual Report on Form 10-K for the fiscal year ended February 3, 2007, in the CRITICAL ACCOUNTING POLICIES section of the Management s Discussion and Analysis of Financial Condition and Results of Operations.

Recent Accounting Pronouncements

Refer to Note 12 to the Condensed Consolidated Financial Statements entitled Recent accounting pronouncements for a discussion of recent accounting pronouncements and their impact on our Condensed Consolidated Financial Statements.

Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, which are intended to be covered by the safe harbors created thereby. All statements herein that are not historical facts, including statements about our

beliefs or expectations, are forward-looking statements. We generally identify these statements by words or phrases, such as anticipate, estimate, plan, expect, believe, intend, foresee, will, may, and similar words or phrases. In our statements discuss, among other things, our strategy, store openings and renovations, future financial or operational performance, anticipated cost savings, results of store closings and restructurings, anticipated domestic or international developments, future financings, targets and future occurrences and trends.

Table of Contents

These statements are subject to risks, uncertainties, and other factors, including, among others, competition in the retail industry, seasonality of our business, changes in consumer preferences and consumer spending patterns, general economic conditions in the United States and other countries in which we conduct our business, our ability to implement our strategy, our substantial level of indebtedness and related debt service obligations and the covenants in our debt agreements, availability of adequate financing, our dependence on key vendors of our merchandise, international events affecting the delivery of toys and other products to our stores, economic, political and other developments associated with our international operations, and risks, uncertainties and factors set forth in our reports and documents filed with the United States Securities and Exchange Commission (which reports and documents should be read in conjunction with this Quarterly Report on Form 10-Q). We believe that all forward-looking statements are based on reasonable assumptions when made; however, we caution that it is impossible to predict actual results or outcomes or the effects of risks, uncertainties or other factors on anticipated results or outcomes and that, accordingly, one should not place undue reliance on these statements. Forward-looking statements speak only as of the date they were made, and we undertake no obligation to update these statements in light of subsequent events or developments. Actual results and outcomes may differ materially from anticipated results or outcomes discussed in any forward-looking statement.

Item 3. Quantitative and Qualitative Disclosures About Market Risk*Foreign Exchange Exposure*

We face transactional currency exposures relating to merchandise purchases in foreign currencies. Through our import merchandise program, we enter into forward exchange contracts to minimize and manage the currency risks associated with the purchase of merchandise inventories. Changes in foreign exchange rates affect interest expense recorded in relation to our foreign currency-denominated derivative instruments and debt instruments. In line with the seasonality of our business, the amount of forward exchange contracts tends to be higher in the first half, than in the second half of the year. As of November 3, 2007, none of our foreign currency-denominated derivatives qualified for hedge accounting treatment. At November 3, 2007, a 10% change in foreign currency rates would have an annualized impact on pre-tax earnings of \$14 million.

Interest Rate Exposure

We have a variety of fixed and variable rate debt instruments and are exposed to market risks resulting from interest rate fluctuations. In an effort to manage interest rate exposures, we strive to achieve an acceptable balance between fixed and variable rate debt and have entered into interest rate swaps and interest rate caps to maintain that balance. A change in interest rates on variable rate debt impacts our pre-tax earnings and cash flows, whereas a change in interest rates on fixed rate debt impacts the fair value of debt on our Condensed Consolidated Balance Sheet. At November 3, 2007, a 1% increase in interest rates would have an unfavorable annualized impact on pre-tax earnings of \$26 million and a 1% decrease in interest rates would have a favorable annualized impact on pre-tax earnings of \$30 million.

Refer to Notes 4 and 5 to the Condensed Consolidated Financial Statements entitled "Short-term borrowings and long-term debt" and "Derivative instruments and hedging activities", respectively, for further details.

For further discussion of our exposure to market risk, refer to Item 7A entitled "QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK" in our Annual Report on Form 10-K for the fiscal year ended February 3, 2007.

Item 4. Controls and Procedures*Disclosure Controls and Procedures*

We maintain disclosure controls and procedures that are designed to provide reasonable assurance regarding the reliability of financial reporting and preparation of financial statements for external purposes in accordance with U.S. Generally Accepted Accounting Principles, and to ensure that information required to be disclosed in our reports under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures.

In connection with the preparation of this Quarterly Report on Form 10-Q and as of the end of the fiscal period covered by this Quarterly Report on Form 10-Q (November 3, 2007), we performed an evaluation, under the

supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934.

Table of Contents

Based on our evaluation as of November 3, 2007, the material weakness in internal control over financial reporting described in Item 9A entitled **CONTROLS AND PROCEDURES** of the Annual Report on Form 10-K for the fiscal year ended February 3, 2007 has not been remediated, and, therefore, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were not effective as of the end of the fiscal period covered by this Quarterly Report on Form 10-Q (November 3, 2007).

We employed alternative procedures to enable management to conclude that reasonable assurance exists regarding the reliability of financial reporting and the preparation of the Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q filing. Accordingly, management believes that the Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q filing fairly present, in all material respects, our financial position, results of operations and cash flows for the periods presented.

Changes in Internal Control over Financial Reporting

During the third quarter of fiscal 2007, we continued efforts to remediate the material weakness in our financial closing and reporting process, as disclosed in Item 9A entitled **CONTROLS AND PROCEDURES** of the Annual Report on Form 10-K for the fiscal year ended February 3, 2007. We continued to implement processing protocols associated with the foreign component of our automated tax software package to efficiently calculate the Company's income tax provision and we hired additional professional tax staff including a Senior Director-Tax Planning. However, management concludes that the control enhancements implemented to date have not been operating effectively for a sufficient period of time in order to fully remediate the material weakness. Other than the foregoing, there were no changes in the Company's internal control over financial reporting during the Company's third quarter of fiscal 2007 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Table of Contents

PART II OTHER INFORMATION

Item 1. Legal Proceedings

Refer to Note 9 to the Condensed Consolidated Financial Statements entitled "Litigation and legal proceedings" for a discussion of material legal proceedings.

Item 1A. Risk Factors

At November 3, 2007, there had not been any material changes to the information related to the ITEM 1A. RISK FACTORS disclosed in the Company's Annual Report on Form 10-K for the fiscal year ended February 3, 2007.

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

None.

Item 3. Defaults Upon Senior Securities

None.

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

None.

Item 5. Other Information

None.

Item 6. Exhibits

Required exhibits are listed in the Index to Exhibits and are incorporated by reference.

Table of Contents

SIGNATURE

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

TOYS R US, INC.
(Registrant)

Date: December 18, 2007

/s/ F. Clay Creasey, Jr.
F. Clay Creasey, Jr.
Executive Vice President Chief Financial
Officer

37

Table of Contents

INDEX TO EXHIBITS

The following is a list of all exhibits filed or furnished as part of this report:

Exhibit No. Description

- 3.3 Amendment No. 1 to the Amended and Restated Certificate of Incorporation of Toys R Us Holdings, Inc., filed with the Secretary of State of the State of Delaware on August 3, 2007.
- 10.1 Amended and Restated Toys R Us Holdings, Inc. 2005 Management Equity Plan, adopted on August 3, 2007.
- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a 14(a) and Rule 15d 14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer pursuant to Rule 13a 14(a) and Rule 15d 14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.