

CONSOLIDATED STATEMENTS OF OPERATIONS

	2007	2006	2005
	(in millions, except per share amounts)		
Sales	\$ 5,437	\$ 5,750	\$ 5,653
Costs and expenses			
Cost of sales	4,017	4,014	3,944
Selling, general and administrative expenses	1,176	1,163	1,129
Depreciation and amortization	166	175	171
Impairment charges and store closing program costs	128	17	—
Interest expense, net.	1	3	10
	<u>5,488</u>	<u>5,372</u>	<u>5,254</u>
Other income	(1)	(14)	(6)
	<u>5,487</u>	<u>5,358</u>	<u>5,248</u>
(Loss) Income from continuing operations before income taxes	(50)	392	405
Income tax (benefit) expense	(99)	145	142
Income from continuing operations	<u>49</u>	<u>247</u>	<u>263</u>
Income on disposal of discontinued operations, net of income tax expense (benefit) of \$1, \$1, and \$(3), respectively ..	2	3	1
Cumulative effect of accounting change, net of income tax benefit of \$ —	—	1	—
Net income	<u>\$ 51</u>	<u>\$ 251</u>	<u>\$ 264</u>
Basic earnings per share:			
Income from continuing operations	\$ 0.32	\$ 1.59	\$ 1.70
Income from discontinued operations	0.01	0.02	0.01
Cumulative effect of accounting change	—	0.01	—
Net income	<u>\$ 0.33</u>	<u>\$ 1.62</u>	<u>\$ 1.71</u>
Diluted earnings per share:			
Income from continuing operations	\$ 0.32	\$ 1.58	\$ 1.67
Income from discontinued operations	0.01	0.02	0.01
Cumulative effect of accounting change	—	—	—
Net income	<u>\$ 0.33</u>	<u>\$ 1.60</u>	<u>\$ 1.68</u>

See Accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED BALANCE SHEETS

	2007	2006
	(in millions)	
ASSETS		
Current assets		
Cash and cash equivalents	\$ 488	\$ 221
Short-term investments	5	249
Merchandise inventories	1,281	1,303
Other current assets	290	261
	<u>2,064</u>	<u>2,034</u>
Property and equipment, net	521	654
Deferred taxes	243	109
Goodwill	266	264
Intangible assets, net	96	105
Other assets	58	83
	<u>\$ 3,248</u>	<u>\$ 3,249</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable	\$ 233	\$ 256
Accrued and other liabilities	268	246
Current portion of long-term debt and obligations under capital leases	—	14
	<u>501</u>	<u>516</u>
Long-term debt and obligations under capital leases	221	220
Other liabilities	255	218
	<u>977</u>	<u>954</u>
Total liabilities		
Shareholders' equity	<u>2,271</u>	<u>2,295</u>
	<u>\$ 3,248</u>	<u>\$ 3,249</u>

See Accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	2007	2006	2005
	(in millions)		
From Operating Activities			
Net income	\$ 51	\$ 251	\$ 264
Adjustments to reconcile net income to net cash provided by operating activities of continuing operations:			
Income on disposal of discontinued operations, net of tax	(2)	(3)	(1)
Non-cash impairment charges and store closing program costs	124	17	—
Cumulative effect of accounting change, net of tax	—	(1)	—
Depreciation and amortization	166	175	171
Share-based compensation expense	10	10	6
Deferred income taxes	(129)	21	24
Change in assets and liabilities:			
Merchandise inventories	55	(38)	(111)
Accounts payable and other accruals	(36)	(103)	14
Qualified pension plan contributions	—	(68)	(26)
Income taxes	—	(3)	(8)
Other, net	44	(69)	16
Net cash provided by operating activities of continuing operations	<u>283</u>	<u>189</u>	<u>349</u>
From Investing Activities			
Acquisitions	—	—	1
Gain from lease termination	1	4	—
Gain from insurance recoveries	1	4	3
Purchases of short-term investments	(1,378)	(1,992)	(2,798)
Sales of short-term investments	1,620	2,041	2,767
Capital expenditures	(148)	(165)	(155)
Proceeds from investment and note	21	—	—
Net cash provided by (used in) investing activities of continuing operations	<u>117</u>	<u>(108)</u>	<u>(182)</u>
From Financing Activities			
Reduction in long-term debt	(7)	(86)	(35)
Repayment of capital lease	(14)	(1)	—
Dividends paid on common stock	(77)	(61)	(49)
Issuance of common stock	9	9	12
Treasury stock reissued under employee stock plans	—	3	2
Purchase of treasury shares	(50)	(8)	(35)
Tax benefit on stock compensation	1	2	—
Net cash used in financing activities of continuing operations	<u>(138)</u>	<u>(142)</u>	<u>(105)</u>
Net Cash Used In operating activities of Discontinued Operations	<u>—</u>	<u>(8)</u>	<u>—</u>
Effect of Exchange Rate Fluctuations on Cash and Cash Equivalents	<u>5</u>	<u>1</u>	<u>2</u>
Net Change in Cash and Cash Equivalents	<u>267</u>	<u>(68)</u>	<u>64</u>
Cash and Cash Equivalents at Beginning of Year	<u>221</u>	<u>289</u>	<u>225</u>
Cash and Cash Equivalents at End of Year	<u>\$ 488</u>	<u>\$ 221</u>	<u>\$ 289</u>
Cash Paid During the Year:			
Interest	\$ 18	\$ 20	\$ 21
Income taxes	\$ 52	\$ 133	\$ 93

See Accompanying Notes to Consolidated Financial Statements.

Property and Equipment

Property and equipment are recorded at cost, less accumulated depreciation and amortization. Significant additions and improvements to property and equipment are capitalized. Maintenance and repairs are charged to current operations as incurred. Major renewals or replacements that substantially extend the useful life of an asset are capitalized and depreciated. Owned property and equipment is depreciated on a straight-line basis over the estimated useful lives of the assets: maximum of 50 years for buildings and 3 to 10 years for furniture, fixtures and equipment. Property and equipment under capital leases and improvements to leased premises are generally amortized on a straight-line basis over the shorter of the estimated useful life of the asset or the remaining lease term. Capitalized software reflects certain costs related to software developed for internal use that are capitalized and amortized. After substantial completion of the project, the costs are amortized on a straight-line basis over a 2 to 7 year period. Capitalized software, net of accumulated amortization, is included in property and equipment and was \$22 million at February 2, 2008 and \$29 million at February 3, 2007.

Recoverability of Long-Lived Assets

In accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No. 144"), an impairment loss is recognized whenever events or changes in circumstances indicate that the carrying amounts of long-lived tangible and intangible assets with finite lives may not be recoverable. Management's policy in determining whether an impairment indicator exists, a triggering event, comprises measurable operating performance criteria at the division level, as well as qualitative measures. The Company considers historical performance and future estimated results, which are predominately identified from the Company's three-year strategic plans, in its evaluation of potential store-level impairment and then compares the carrying amount of the asset with the estimated future cash flows expected to result from the use of the asset. If the carrying amount of the asset exceeds the estimated expected undiscounted future cash flows, the Company measures the amount of the impairment by comparing the carrying amount of the asset with its estimated fair value. The estimation of fair value is measured by discounting expected future cash flows at the Company's weighted-average cost of capital. The Company estimates fair value based on the best information available using estimates, judgments and projections as considered necessary.

Goodwill and Intangible Assets

The Company accounts for goodwill and other intangibles in accordance with SFAS No. 142, "Goodwill and Other Intangible Assets," which requires that goodwill and intangible assets with indefinite lives be reviewed for impairment if impairment indicators arise and, at a minimum, annually.

The Company performs its annual impairment review as of the beginning of each fiscal year. The fair value of each reporting unit is determined using a combination of market and discounted cash flow approaches. During the third and fourth quarters of 2007, the Company performed reviews of its U.S. Athletic stores' goodwill, as a result of the SFAS No. 144 recoverability analysis. These analyses did not result in an impairment charge. Separable intangible assets that are deemed to have finite lives will continue to be amortized over their estimated useful lives. Intangible assets with finite lives primarily reflect lease acquisition costs and are amortized over the lease term.

Derivative Financial Instruments

All derivative financial instruments are recorded in the Consolidated Balance Sheets at their fair values. Changes in fair values of derivatives are recorded each period in earnings, other comprehensive gain or loss, or as a basis adjustment to the underlying hedged item, depending on whether a derivative is designated and effective as part of a hedge transaction. The effective portion of the gain or loss on the hedging derivative instrument is reported as a component of other comprehensive income/loss or as a basis adjustment to the underlying hedged item and reclassified to earnings in the period in which the hedged item affects earnings.

The effective portion of the gain or loss on hedges of foreign net investments is generally not reclassified to earnings unless the net investment is disposed of. To the extent derivatives do not qualify as hedges, or are ineffective, their changes in fair value are recorded in earnings immediately, which may subject the Company to increased earnings volatility. The changes in the fair value of the Company's hedges of net investments in various foreign subsidiaries is computed using the spot method.

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Accounting for Leases

The Company recognizes rent expense for operating leases as of the possession date for store leases or the commencement of the agreement for a non-store lease. Rental expense, inclusive of rent holidays, concessions and tenant allowances are recognized over the lease term on a straight-line basis. Contingent payments based upon sales and future increases determined by inflation related indices cannot be estimated at the inception of the lease and accordingly, are charged to operations as incurred.

Foreign Currency Translation

The functional currency of the Company's international operations is the applicable local currency. The translation of the applicable foreign currency into U.S. dollars is performed for balance sheet accounts using current exchange rates in effect at the balance sheet date and for revenue and expense accounts using the weighted-average rates of exchange prevailing during the year. The unearned gains and losses resulting from such translation are included as a separate component of accumulated other comprehensive loss within shareholders' equity.

Recent Accounting Pronouncements Not Previously Discussed Herein

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS No. 157") which is effective for fiscal years beginning after November 15, 2007 and for interim periods within those years. This statement defines fair value, establishes a framework for measuring fair value and expands the related disclosure requirements. However, the FASB issued FASB Staff Positions ("FSP") 157-1 and 157-2. FSP 157-1 amends SFAS No. 157 to exclude FASB No. 13, "Accounting for Leases," and its related interpretive accounting pronouncements that address leasing transactions, while FSP-2 delays the effective date of SFAS No. 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis, until fiscal years beginning after November 15, 2008. The Company does not believe that this standard will significantly affect the Company's financial position or results of operations.

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." This statement permits, but does not require, entities to measure many financial instruments at fair value. The objective is to provide entities with an opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. The Company does not believe that this standard will significantly affect the Company's financial position or results of operations.

In December 2007, the FASB issued SFAS No. 141 (Revised 2007), "Business Combinations," ("SFAS No. 141(R)"). This standard will significantly change the accounting for business combinations. Under SFAS No. 141(R), an acquiring entity will be required to recognize all the assets acquired and liabilities assumed in a transaction at the acquisition-date fair value with limited exceptions. SFAS No. 141(R) also includes a substantial number of new disclosure requirements. SFAS No. 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements - An Amendment of ARB No. 51" ("SFAS No. 160"), which establishes new accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. Specifically, this statement requires the recognition of a noncontrolling interest (minority interest) as equity in the consolidated financial statements and separate from the parent's equity. SFAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. This standard does not currently affect the Company.

2. Impairment of Long-Lived Assets and Store Closing Program

During 2007, the Company concluded that triggering events had occurred at its U.S. retail store divisions, comprising Foot Locker, Lady Foot Locker, Kids Foot Locker, Footaction, and Champs Sports. Accordingly, the Company evaluated the long-lived assets of those operations for impairment and recorded non-cash impairment charges of \$117 million primarily to write-down long-lived assets such as store fixtures and leasehold improvements for 1,395 stores at the Company's U.S. store operations pursuant to SFAS No. 144.

9. Property and Equipment, Net

	<u>2007</u>	<u>2006</u>
	(in millions)	
Land	\$ 3	\$ 3
Buildings:		
Owned	30	30
Furniture, fixtures and equipment:		
Owned	1,117	1,139
Leased	<u>—</u>	<u>14</u>
	1,150	1,186
Less: accumulated depreciation	<u>(903)</u>	<u>(870)</u>
	247	316
Alterations to leased and owned buildings, net of accumulated amortization	<u>274</u>	<u>338</u>
	<u>\$ 521</u>	<u>\$ 654</u>

13. Accrued and Other Liabilities

	<u>2007</u>	<u>2006</u>
	(in millions)	
Pension and postretirement benefits	\$ 4	\$ 4
Incentive bonuses	5	12
Other payroll and payroll related costs, excluding taxes	52	46
Taxes other than income taxes	44	46
Property and equipment	23	24
Customer deposits ⁽¹⁾	34	33
Income taxes payable	7	2
Fair value of derivative contracts	—	2
Current deferred tax liabilities	13	4
Sales return reserve	4	4
Current portion of repositioning and restructuring reserves	—	1
Current portion of reserve for discontinued operations	14	3
Other operating costs	<u>68</u>	<u>65</u>
	<u>\$ 268</u>	<u>\$ 246</u>

(1) Customer deposits include unredeemed gift cards and certificates, merchandise credits and, deferred revenue related to undelivered merchandise, including layaway sales.