COSTCO WHOLESALE CORP /NEW
Form 10-Q
June 12, 2009
**Table of Contents**

# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended May 10, 2009**

**OR**

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission file number 0-20355

# Costco Wholesale Corporation

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **Washington** | **91-1223280** |
| (State or other jurisdiction of | (I.R.S. Employer |

| | |
|---|---|
| incorporation or organization) | Identification No.) |

**999 Lake Drive, Issaquah, WA 98027**

(Address of principal executive office)

(Zip Code)

(Registrant s telephone number, including area code): **(425) 313-8100**

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES ¨ NO ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of large accelerated filer , accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

| | |
|---|---|
| Large accelerated filer x | Accelerated filer ¨ |
| Non-accelerated filer ¨ (Do not check if a smaller company) | Smaller reporting company ¨ |

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act) YES ¨ NO x

The number of shares outstanding of the issuer s common stock as of May 29, 2009 was 434,879,978

Table of Contents

**COSTCO WHOLESALE CORPORATION**

**INDEX TO FORM 10-Q**

**Table of Contents**

## PART I FINANCIAL INFORMATION

### Item 1 Financial Statements

### COSTCO WHOLESALE CORPORATION

### CONDENSED CONSOLIDATED BALANCE SHEETS

**(dollars in millions, except par value and share data)**

**(unaudited)**

| | May 10, 2009 | August 31, 2008 |
|---|---|---|
| **ASSETS** | | |
| **CURRENT ASSETS** | | |
| Cash and cash equivalents | $ 3,083 | $ 2,619 |
| Short-term investments | 585 | 656 |
| Receivables, net | 747 | 748 |
| Merchandise inventories | 5,277 | 5,039 |
| Deferred income taxes and other current assets | 395 | 400 |
| Total current assets | 10,087 | 9,462 |
| **PROPERTY AND EQUIPMENT** | | |
| Land | 3,241 | 3,217 |
| Buildings, leasehold and land improvements | 8,014 | 7,749 |
| Equipment and fixtures | 3,238 | 3,057 |
| Construction in progress | 307 | 306 |
| | 14,800 | 14,329 |
| Less accumulated depreciation and amortization | (4,302) | (3,974) |
| Net property and equipment | 10,498 | 10,355 |
| **OTHER ASSETS** | 719 | 865 |
| **TOTAL ASSETS** | $ 21,304 | $ 20,682 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | |
| **CURRENT LIABILITIES** | | |
| Short-term borrowings | $ 16 | $ 134 |
| Accounts payable | 5,370 | 5,225 |
| Accrued salaries and benefits | 1,275 | 1,321 |
| Accrued sales and other taxes | 332 | 283 |
| Deferred membership fees | 842 | 748 |
| Current portion of long-term debt | 76 | 6 |
| Other current liabilities | 1,348 | 1,157 |
| Total current liabilities | 9,259 | 8,874 |
| **LONG-TERM DEBT, excluding current portion** | 2,145 | 2,206 |
| **DEFERRED INCOME TAXES AND OTHER LIABILITIES** | 336 | 328 |

| | | |
|---|---|---|
| Total liabilities | 11,740 | 11,408 |
| **COMMITMENTS AND CONTINGENCIES** | | |
| **MINORITY INTEREST** | 91 | 82 |
| **STOCKHOLDERS EQUITY** | | |
| Preferred stock $.005 par value; 100,000,000 shares authorized; no shares issued and outstanding | | |
| Common stock $.005 par value; 900,000,000 shares authorized; 434,868,000 and 432,513,000 shares issued and outstanding | 2 | 2 |
| Additional paid-in capital | 3,722 | 3,543 |
| Accumulated other comprehensive (loss) income | (57) | 286 |
| Retained earnings | 5,806 | 5,361 |
| Total stockholders equity | 9,473 | 9,192 |
| **TOTAL LIABILITIES AND STOCKHOLDERS EQUITY** | $ 21,304 | $ 20,682 |

The accompanying notes are an integral part of these condensed consolidated financial statements.

3

Table of Contents

**COSTCO WHOLESALE CORPORATION**

**CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

**(dollars in millions, except per share data)**

**(unaudited)**

| | 12 Weeks Ended | | 36 Weeks Ended | |
|---|---|---|---|---|
| | May 10, 2009 | May 11, 2008 | May 10, 2009 | May 11, 2008 |
| **REVENUE** | | | | |
| Net sales | $ 15,477 | $ 16,263 | $ 48,001 | $ 48,351 |
| Membership fees | 329 | 351 | 1,043 | 1,032 |
| Total revenue | 15,806 | 16,614 | 49,044 | 49,383 |
| **OPERATING EXPENSES** | | | | |
| Merchandise costs | 13,776 | 14,548 | 42,823 | 43,205 |
| Selling, general and administrative | 1,655 | 1,582 | 4,998 | 4,767 |
| Preopening expenses | 9 | 9 | 29 | 40 |
| Provision for impaired assets and closing costs, net | 7 | 9 | 15 | 6 |
| Operating income | 359 | 466 | 1,179 | 1,365 |
| **OTHER INCOME (EXPENSE)** | | | | |
| Interest expense | (25) | (25) | (75) | (71) |
| Interest income and other | 4 | 24 | 30 | 98 |
| **INCOME BEFORE INCOME TAXES** | 338 | 465 | 1,134 | 1,392 |
| Provision for income taxes | 128 | 170 | 422 | 507 |
| **NET INCOME** | $ 210 | $ 295 | $ 712 | $ 885 |
| **NET INCOME PER COMMON SHARE:** | | | | |
| Basic | $ 0.48 | $ 0.68 | $ 1.64 | $ 2.04 |
| Diluted | $ 0.48 | $ 0.67 | $ 1.62 | $ 1.99 |
| Shares used in calculation (000 s) | | | | |
| Basic | 434,354 | 433,678 | 433,426 | 434,515 |
| Diluted | 439,997 | 443,281 | 439,995 | 444,379 |
| Dividends per share | $ 0.180 | $ 0.160 | $ 0.50 | $ 0.450 |

The accompanying notes are an integral part of these condensed consolidated financial statements.

**Table of Contents**

**COSTCO WHOLESALE CORPORATION**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(dollars in millions)**

**(unaudited)**

| | 36 Weeks Ended | |
|---|---|---|
| | **May 10, 2009** | **May 11, 2008** |
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | |
| Net income | $ 712 | $ 885 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 487 | 436 |
| Stock-based compensation | 132 | 116 |
| Undistributed equity earnings in joint ventures | (22) | (29) |
| Net gain on sale of property, equipment, investments and other | (2) | (6) |
| Provision on impaired assets | 9 | 9 |
| Accretion of discount on long-term debt | 2 | 2 |
| Excess tax benefit on share based awards | (2) | (35) |
| Other-than-temporary impairment loss on investments | 12 | 4 |
| Other non-cash items, net | 42 | |
| Change in deferred income taxes | 2 | (34) |
| Change in receivables, other current assets, deferred membership fees, accrued and other current liabilities | 219 | 401 |
| Increase in merchandise inventories | (346) | (401) |
| Increase in accounts payable | 263 | 415 |
| Net cash provided by operating activities | 1,508 | 1,763 |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | |
| Additions to property and equipment, net of $23 and $25 of non-cash capital expenditures in the first thirty-six weeks of 2009 and 2008, respectively | (897) | (1,149) |
| Proceeds from the sale of property and equipment | 5 | 15 |
| Purchases of short-term investments | (1,386) | (1,097) |
| Maturities of short-term investments | 1,389 | 1,013 |
| Sales of short-term investments | 119 | 134 |
| Change in certain other assets and other, net | (3) | (11) |
| Investments transferred from cash and cash equivalents | (5) | (371) |
| Net cash used in investing activities | (778) | (1,466) |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | |
| Change in bank checks outstanding | 4 | 180 |
| Repayments of short-term borrowings | (1,729) | (3,438) |
| Proceeds from short-term borrowings | 1,624 | 3,446 |
| Proceeds from issuance of long-term debt, net | | 75 |
| Repayments of long-term debt | (4) | (39) |
| Cash dividend payments | (139) | (126) |
| Change in minority interests | 9 | 8 |
| Excess tax benefit on share based awards | 2 | 35 |
| Proceeds from exercise of stock options | 77 | 282 |
| Repurchases of common stock | (69) | (661) |
| Net cash used in financing activities | (225) | (238) |
| **EFFECT OF EXCHANGE RATE CHANGES ON CASH** | (41) | 10 |

| | | |
|---|---|---|
| Net increase in cash and cash equivalents | 464 | 69 |
| **CASH AND CASH EQUIVALENTS BEGINNING OF YEAR** | 2,619 | 2,780 |
| **CASH AND CASH EQUIVALENTS END OF PERIOD** | $ 3,083 | $ 2,849 |
| **SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:** | | |
| Cash paid during the period for: | | |
| Interest (reduced by $6 and $11 interest capitalized in the first thirty-six weeks of 2009 and 2008, respectively) | $ 106 | $ 110 |
| Income taxes | $ 316 | $ 318 |
| **SUPPLEMENTAL DISCLOSURE OF NON-CASH FINANCING ACTIVITIES:** | | |
| Cash dividend declared, but not yet paid | $ 78 | $ 70 |
| Common stock issued upon conversion of 3.5% Zero Coupon Convertible Subordinated Notes | $ 3 | $ |

The accompanying notes are an integral part of these condensed consolidated financial statements.

5

**Table of Contents**

**COSTCO WHOLESALE CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(dollars in millions, except as noted and per share data)**

**(unaudited)**

**NOTE (1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

*Basis of Presentation*

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q for interim financial reporting pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). While these statements reflect all normal recurring adjustments that are, in the opinion of management, necessary for fair presentation of the results of the interim period, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. Therefore, the interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the Company s annual report filed on Form 10-K, as amended, for the fiscal year ended August 31, 2008.

The condensed consolidated financial statements include the accounts of Costco Wholesale Corporation, a Washington corporation, and its subsidiaries ( Costco or the Company ). All material inter-company transactions among the Company and its subsidiaries have been eliminated in consolidation.

Costco operates membership warehouses that offer low prices on a limited selection of nationally branded and select private label products in a wide range of merchandise categories in no-frills, self-service facilities. At May 10, 2009, Costco operated 523 warehouses in 40 states and Puerto Rico (407 locations), nine Canadian provinces (76 locations), the United Kingdom (21 locations), Korea (six locations), Taiwan (five locations) and Japan (eight locations), as well as 31 locations in Mexico, through a 50%-owned joint venture.

*Fiscal Year End*

Costco operates on a 52/53-week fiscal year basis with the fiscal year ending on the Sunday closest to August 31. References to the third quarters of 2009 and 2008 relate to the 12-week fiscal quarters ended May 10, 2009 and May 11, 2008, respectively. References to the first thirty-six weeks of 2009 and 2008 relate to the thirty-six weeks ended May 10, 2009 and May 11, 2008, respectively.

*Merchandise Inventories*

Merchandise inventories are valued at the lower of cost or market, as determined primarily by the retail inventory method, and are stated using the last-in, first-out (LIFO) method for substantially all U.S. merchandise inventories. Merchandise inventories for all foreign operations are primarily valued by the retail inventory method and are stated using the first-in, first-out (FIFO) method. The Company believes the LIFO method more fairly presents the results of operations by more closely matching current costs with current revenues. The Company records an adjustment each quarter, if necessary, for the expected annual effect of inflation or deflation, and these estimates are adjusted to actual results determined at year-end. During the third quarter and first thirty-six weeks of 2009, the LIFO inventory adjustment increased merchandise inventory and gross margin (net sales less merchandise costs) by $7 and $16, respectively, lowering the LIFO reserve to $16 at the end of the third quarter, as compared to $32 at the end of fiscal 2008. There was no LIFO adjustment in the third quarter or the first thirty-six weeks of 2008.

**Table of Contents**

**NOTE (1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

*Other Assets*

The Company adjusts the carrying value of its life insurance contracts to the cash surrender value at the end of each reporting period. The adjustment reflects changes in the market values of the underlying investment securities and is included in selling, general and administrative expenses. The performance of the investment portfolio associated with these contracts is subject to conditions generally affecting equity and debt markets. The adjustment to cash surrender value was a benefit of $3 and $2 in the third quarter of 2009 and 2008, respectively. The adjustment to the cash surrender value was a decrement of $26 and $3 in the first thirty-six weeks of 2009 and 2008, respectively, and is reflected in other non-cash items, net, in cash flows from operations in the accompanying condensed consolidated statements of cash flows.

*Derivatives*

Effective November 24, 2008, the beginning of the Company s second quarter of 2009, the Company adopted the disclosure requirements of Statement of Financial Accounting Standards (SFAS) No. 161, Disclosures about Derivative Instruments and Hedging Activities an Amendment of FASB Statement No. 133 (SFAS 161). The Company follows SFAS 133, Accounting for Derivative Instruments and Hedging Activities (as amended) (SFAS 133), in accounting for derivative and hedging activities. The Company is exposed to foreign currency exchange-rate fluctuations in the normal course of its business, which the Company manages, in part, through the use of forward foreign exchange contracts, seeking to hedge the impact of fluctuations of foreign exchange on known future expenditures denominated in a foreign currency. Currently, these instruments do not qualify for derivative hedge accounting. The Company uses these instruments to mitigate risk and does not intend to engage in speculative transactions. The forward foreign exchange contracts are entered into by the Company primarily to hedge U.S. dollar merchandise inventory expenditures. The aggregate notional amount of forward foreign exchange contracts was $129 and $90 at May 10, 2009 and August 31, 2008, respectively. These contracts do not contain any credit-risk-related contingent features.

The Company seeks to manage the counterparty risk associated with these forward foreign exchange contracts by limiting transactions to counterparties with which the Company has an established banking relationship. There can be no assurance, however, that this effectively mitigates counterparty risk. In addition, the contracts are limited to a time period of less than one year. See Note 3, Fair Value Measurement, for information on the fair value of these contracts.

At May 10, 2009, the fair value of the Company s derivatives, which do not qualify for hedge accounting under SFAS 133, was as follows:

| | Asset | Liability |
|---|---|---|
| Forward foreign exchange contracts [1] | $ 1 | $ 4 |
| Total derivatives | $ 1 | $ 4 |

(1) The asset and the liability values are included in deferred income taxes and other current assets and other current liabilities, respectively, in the accompanying condensed consolidated balance sheets.

**Table of Contents**

**NOTE (1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

The following table summarizes the amount of gain or (loss) recognized in interest income and other in the accompanying condensed consolidated statements of income:

| | 12 Weeks Ended | | 36 Weeks Ended | |
|---|---|---|---|---|
| | May 10, 2009 | May 11, 2008 | May 10, 2009 | May 11, 2008 |
| Forward foreign exchange contracts | $ (8) | $ | $ (6) | $ 3 |
| Total | $ (8) | $ | $ (6) | $ 3 |

The Company is exposed to risks due to fluctuations in energy prices, particularly electricity, which it seeks to partially mitigate through the use of fixed-price contracts with counterparties for approximately 21% of its warehouses as well as other facilities in the U.S. and Canada. The Company has also entered into variable-priced derivative contracts for some purchases of natural gas and fuel for its gas stations on an index basis. These contracts qualify for treatment as normal purchase or normal sales under SFAS 133 and require no mark-to-market adjustment.

*Stock Repurchase Programs*

Shares repurchased are retired, in accordance with the Washington Business Corporation Act. The par value of repurchased shares is deducted from common stock and the remaining excess of repurchase price over par value is deducted from additional paid-in capital and retained earnings. See Note 5 for additional information.

*Recent Accounting Pronouncements*

In May 2009, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 165, Subsequent Events (SFAS 165), which establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS 165 applies prospectively to both interim and annual financial periods ending after June 15, 2009. The Company must adopt these new requirements in its fourth quarter of fiscal 2009.

In April 2009, three FASB Staff Positions (FSPs) were issued addressing fair value of financial instruments: FSP FAS 157-4 addresses determining fair values in inactive markets; FSP FAS 115-2 addresses other-than-temporary impairments for debt securities; and FSP FAS 107-1 requires interim disclosures about fair value of financial instruments. The Company will adopt these FSPs in its fourth quarter of fiscal 2009.

In September 2006, the FASB issued SFAS 157, Fair Value Measurements (SFAS 157), which establishes a framework for measuring fair value and requires expanded disclosures regarding fair value measurements. In February 2008, the FASB issued FSP FAS 157-2, Effective Date of FASB Statement 157 (FSP 157-2), which allows for the deferral of the adoption date of SFAS 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. The Company elected to defer the adoption of SFAS 157 for the assets and liabilities within the scope of FSP 157-2. The Company will adopt FSP 157-2 on August 31, 2009, the beginning of its fiscal 2010. In October 2008, the FASB issued FSP FAS 157-3, Determining the Fair Value of a Financial Asset in a Market That Is Not Active (FSP 157-3), which clarifies the application of SFAS 157 when the market for a financial asset is inactive. The adoption of SFAS 157 for those assets and liabilities not subject to the deferral permitted by FSP 157-2 did not have a material impact on the Company s financial position or results of operations and is summarized

**NOTE (1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

in Note 3, Fair Value Measurements, of this Form 10-Q. The Company does not expect the adoption of SFAS 157 for non-financial assets and liabilities to have a material impact on its consolidated financial statements.

In June 2008, the FASB issued Staff Position EITF 03-06-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities (FSP EITF 03-06-1). FSP EITF 03-06-1 provides that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method in SFAS No. 128, Earnings per Share. This FSP is effective for financial statements issued for fiscal years beginning after December 15, 2008 and interim periods within those fiscal years. The Company s unvested RSUs are not eligible to receive dividends; therefore, EITF 03-06-1 will not have any impact on the Company s consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements, an Amendment of Accounting Research Bulletin No 51 (SFAS 160). SFAS 160 establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, changes in a parent s ownership of a noncontrolling interest, calculation and disclosure of the consolidated net income attributable to the parent and the noncontrolling interest, changes in a parent s ownership interest while the parent retains its controlling financial interest and fair value measurement of any retained noncontrolling equity investment. SFAS 160 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early adoption is prohibited. The Company must adopt these new requirements in its first quarter of fiscal 2010.

In December 2007, the FASB issued SFAS No. 141R, Business Combinations (SFAS 141R), which establishes principles and requirements for the reporting entity in a business combination, including recognition and measurement in the financial statements of the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. SFAS 141R 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, and interim periods within those fiscal years. The Company must adopt these new requirements in its first quarter of fiscal 2010.

Except as noted above, the Company is in the process of evaluating the impact that adoption of these standards will have on its future consolidated financial statements.

*Use of Estimates*

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

*Reclassifications*

Certain reclassifications have been made to prior fiscal year amounts or balances to conform to the presentation adopted in the current fiscal year, which did not have any impact to consolidated net income or stockholders equity amounts previously reported.

**Table of Contents**

**NOTE (2) INVESTMENTS**

In December 2007, one of the Company s enhanced money fund investments, Columbia Strategic Cash Portfolio Fund (Columbia), ceased accepting cash redemption requests and changed to a floating net asset value. In light of the restricted liquidity, the Company elected to receive a pro-rata allocation of the underlying securities in a separately managed account. The Company assesses the fair value of these securities through market quotations and review of current investment ratings, as available, coupled with an evaluation of the liquidation value of each investment and its current performance in meeting scheduled payments of principal and interest. During the third quarter of 2009 and 2008, the Company recognized $5 and $1, respectively, of other-than-temporary impairment losses related to these securities. During the first thirty-six weeks of 2009 and 2008, the Company recognized $12 and $4, respectively, of other-than-temporary impairment losses related to these securities. The losses are included in interest income and other in the accompanying condensed consolidated statements of income. At May 10, 2009 and August 31, 2008, the balance of the Columbia fund was $52 and $104, respectively, on the condensed consolidated balance sheets.

In December 2007, two other enhanced money fund investments, BlackRock Cash Strategies, LLC (BlackRock) and Merrill Lynch Capital Reserve Fund, LLC (Merrill Lynch), ceased accepting redemption requests and commenced liquidation. During the second quarter of fiscal 2009, BlackRock was liquidated and the Company received the remaining $21 balance of its investment. As of August 31, 2008, the balance of the BlackRock fund was $82 on the condensed consolidated balance sheets. As of May 10, 2009 and August 31, 2008, the balance of the Merrill Lynch fund was $26 and $43, respectively, on the condensed consolidated balance sheets. Subsequent to the end of the third quarter of 2009, the Company received the remaining $26 balance in the Merrill Lynch fund.

During fiscal 2008, the Company reclassified a portion of these three funds from cash and cash equivalents to short-term investments and other assets. At May 10, 2009, $59 remained in short-term investments and $19 remained in other assets on the condensed consolidated balance sheets, reflecting the timing of the expected distributions. These amounts represented the then remaining investment balance in the Merrill Lynch and Columbia fund. At August 31, 2008, $161 remained in short-term investments and $68 remained in other assets on the condensed consolidated balance sheets.

The markets relating to these investments remain uncertain, and there may be further declines in the value of these investments that may cause additional losses in future periods.

**NOTE (3) FAIR VALUE MEASUREMENT**

The Company adopted SFAS 157, as amended by FSP 157-1, FSP 157-2, and FSP 157-3 (collectively referred to as SFAS 157), on September 1, 2008, for all financial assets and liabilities that are recognized or disclosed at fair value in the condensed consolidated financial statements on a recurring basis or on a nonrecurring basis during the reporting period. While the Company adopted the provisions of SFAS 157 for nonfinancial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a recurring basis, no such assets or liabilities existed at the balance sheet date. The Company, in accordance with FSP 157-2, delayed implementation of SFAS 157 for all nonfinancial assets and liabilities recognized or disclosed at fair value in the financial statements on a nonrecurring basis. Nonfinancial nonrecurring assets and liabilities included on the Company s condensed consolidated balance sheets include items, such as goodwill and long lived assets, that are measured at fair value to test for and measure an impairment charge, when necessary.

**Table of Contents**

**NOTE (3) FAIR VALUE MEASUREMENT (Continued)**

SFAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the measurement date. SFAS 157 also establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs when measuring fair value. The standard describes three levels of inputs:

Level 1: Quoted market prices in active markets for identical assets or liabilities.
Level 2: Observable market-based inputs or unobservable inputs that are corroborated by market data.
Level 3: Significant unobservable inputs that are not corroborated by market data.

The following valuation techniques are used to measure fair value:

Level 1 primarily consists of financial instruments, such as money market mutual funds, whose value is based on quoted market prices, such as quoted net asset values published by the fund as supported in an active market, exchange-traded instruments and listed equities.

Level 2 includes assets and liabilities where quoted market prices are unobservable but observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities, could be obtained from data providers or pricing vendors. The Company s Level 2 assets and liabilities primarily include U.S. Government and agency securities, investments in corporate notes and bonds, asset and mortgage-backed securities, the cash surrender value of life insurance policies covering employees, and forward foreign exchange contracts. Valuation methodologies are based on consensus pricing, using market prices from a variety of industry-standard independent data providers or pricing that considers various assumptions, including time value, yield curve, volatility factors, credit spreads, default rates, loss severity, current market and contractual prices for the underlying instruments or debt, broker and dealer quotes, as well as other relevant economic measures. All are observable in the market or can be derived principally from or corroborated by observable market data, for which the Company typically receives independent external valuation information.

Level 3 is comprised of significant unobservable inputs for valuations from our independent data and pricing providers that are also supported by little, infrequent, or no market activity. Limited amounts of the Company s investments, which comprise the majority of securities in the Columbia fund that have not yet been sold or liquidated, are invested in asset and mortgage-backed securities and corporate notes and bonds that are classified as Level 3 based upon management s assessment of the available inputs. Management considers indicators of significant unobservable inputs such as the lengthening of maturities, later-than scheduled payments, and any securities that have defaulted, as indicators of Level 3. Assets and liabilities are considered Level 3 when their fair value inputs are unobservable, unavailable or management concludes that even though there may be some observable inputs, an item should be classified as a Level 3 based on other indicators of significant unobservable inputs, such as situations involving limited market activity, where determination of fair value requires significant judgment or estimation. At May 10, 2009, these investment securities were measured at fair value primarily using information provided by the portfolio managers that considered quoted prices of comparable securities, but whose valuations also included significant unobservable inputs, such as estimates of fair value based on assumptions regarding credit quality, liquidity and expected future cash flows for interest and principal payments based on expected maturities and the timing of future payments.

**Table of Contents**

**NOTE (3) FAIR VALUE MEASUREMENT (Continued)**

During the third quarter of 2009, the Company considered continuing indicators of significant unobservable inputs, such as the lengthening of maturities, later-than-scheduled payments, and any securities that have defaulted, as Level 3 inputs for valuation. This resulted in a transfer of $37 into the Level 3 from Level 2. Transfers into and out of the Level 3 from Level 2, where applicable, are reported using the fair value of the individual securities as of the beginning of the reporting period in which the transfer occurred. At May 10, 2009, all of the Company s Level 3 investments, or $49, were comprised of individual securities in the Columbia fund and represent the majority of the balance of the fund of $52 at May 10, 2009.

*Assets and Liabilities Measured at Fair Value on a Recurring Basis*

The following table presents information about the Company s financial assets and financial liabilities that are measured at fair value on a recurring basis as of May 10, 2009, and indicates the fair value hierarchy of the valuation techniques utilized to determine such fair value:

| | Level 1 | Level 2 | Level 3 |
|---|---|---|---|
| Assets / (liabilities): | | | |
| Money market mutual funds | $ 1,619 | $ | $ |
| Investment in U.S. government and agency securities | | 386 | |
| Investment in corporate notes and bonds | | 44 | 21 |
| Investment in asset and mortgage-backed securities | | 43 | 28 |
| Cash surrender value of life insurance policies | | 64 | |
| Forward foreign exchange contracts, in asset position (1) | | 1 | |
| Forward foreign exchange contracts, in liability position (1) | | (4) | |
| Total | $ 1,619 | $ 534 | $ 49 |

(1) See Note 1 for additional information on derivative instruments.

The table below provides a summary of the changes in fair value, including net transfers, of all financial assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the third quarter and first thirty-six weeks of 2009:

| | 12 Weeks ended May 10, 2009 | | |
|---|---|---|---|
| | Investment in corporate notes and bonds | Investment in asset and mortgage-backed securities | Total |
| Balance, beginning of period | $ 5 | $ 15 | $ 20 |
| Total realized and unrealized gains (losses): | | | |
| Included in other comprehensive (loss) income | 1 | 2 | 3 |
| Included in interest income and other | | (4) | (4) |
| Change in accrued interest included in interest income and other | | | |
| Purchases, issuances, and (settlements) | (3) | (4) | (7) |
| Transfers in (out) | 18 | 19 | 37 |
| Balance, end of period | $ 21 | $ 28 | $ 49 |

| | | | |
|---|---|---|---|
| Change in unrealized gains (losses) included in interest income and other related to assets held as of May 10, 2009 | $ | (4) | (4) |

12

**Table of Contents**

**NOTE (3) FAIR VALUE MEASUREMENT (Continued)**

| | 36 Weeks ended May 10, 2009 | | |
|---|---|---|---|
| | Investment in corporate notes and bonds | Investment in asset and mortgage-backed securities | Total |
| Balance, beginning of period | $ 12 | $ 6 | $ 18 |
| Total realized and unrealized gains (losses): | | | |
| Included in other comprehensive (loss) income | | 2 | 2 |
| Included in interest income and other | (4) | (7) | (11) |
| Change in accrued interest included in interest income and other | | | |
| Purchases, issuances, and (settlements) | (10) | (4) | (14) |
| Transfers in (out) | 23 | 31 | 54 |
| Balance, end of period | $ 21 | $ 28 | $ 49 |
| Change in unrealized gains (losses) included in interest income and other related to assets held as of May 10, 2009 | $ (4) | (7) | (11) |

*Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis*

As discussed in Note 2, the Company holds enhanced money fund investments that are liquidating. These holdings are classified as held-to-maturity investments and are, therefore, not adjusted to market value at the end of each reporting period. Fair value would only be determined on a nonrecurring basis if these investments were deemed to be other-than-temporarily impaired. The Company has not recorded any other-than-temporary impairment losses on these investments during the reporting periods. The Company s holdings in these enhanced money funds within BlackRock and Merrill Lynch were fully liquidated during the second quarter of 2009 and subsequent to the end of the third quarter of 2009, respectively.

**NOTE (4) LONG-TERM DEBT**

During the third quarter of 2009, a nominal amount of the face value of the Company s 3.5% Zero Coupon Convertible Subordinated Notes (Zero Coupon Notes) was converted by note holders into 5,000 shares of common stock; and during the first thirty-six weeks of 2009, $4 in face amount of Zero Coupon Notes was converted by note holders into 82,000 shares of common stock. During the third quarter and first thirty-six weeks of 2008, a nominal amount of the face value of Zero Coupon Notes was converted by note holders into 1,000 and 7,000 shares of common stock, respectively. These amounts differ from those in the supplemental disclosure of non-cash items in the condensed consolidated statements of cash flows due to the related discount and issuance costs.

**NOTE (5) STOCKHOLDERS EQUITY**

*Dividends*

In the third quarter of 2009, the Company s Board of Directors declared a quarterly cash dividend to shareholders of record as of May 15, 2009 and approved an increase from $0.16 to $0.18 per share, or $0.72 on an annualized basis. The dividend was paid on May 29, 2009.

Payment of future dividends is subject to declaration by the Board of Directors. Factors considered in determining the size of the dividends are profitability and expected capital needs of the Company. The Company presently expects to continue to pay dividends on a quarterly basis.

**Table of Contents**

**NOTE (5) STOCKHOLDERS EQUITY (Continued)**

*Stock Repurchase Programs*

The Company s stock repurchase activity during the third quarter and first thirty-six weeks of 2009 and 2008 is summarized in the following table:

| | Shares Repurchased (000 s) | Average Price per Share | Total Expenditure |
|---|---|---|---|
| Third quarter of 2009 | 50 | $ 38.88 | $ 2 |
| First thirty-six weeks of 2009 | 895 | $ 63.84 | $ 57 |
| Third quarter of 2008 | 3,750 | $ 64.25 | $ 241 |
| First thirty-six weeks of 2008 | 10,112 | $ 63.42 | $ 641 |

These amounts differ from the stock repurchase balances in the condensed consolidated statements of cash flows to the extent that repurchases had not settled at the end of the quarter. The remaining amount available for stock repurchases under the approved plans was approximately $2,002 at May 10, 2009. Purchases are made from time-to-time as conditions warrant in the open market or in block purchases, and pursuant to share repurchase plans under SEC Rule 10b5-1. Repurchased shares are retired.

*Comprehensive Income*

Comprehensive income includes net income plus certain other items that are recorded directly to stockholders equity. Accumulated other comprehensive income (loss) reported on the Company s condensed consolidated balance sheets consists of foreign currency translation adjustments and unrealized gains and losses on investments and their related tax effects.

The following table shows the components of comprehensive income, net of related tax effects:

| | 12 Weeks Ended | | 36 Weeks Ended | |
|---|---|---|---|---|
| | May 10, 2009 | May 11, 2008 | May 10, 2009 | May 11, 2008 |
| Unrealized gain (loss) on short-term investments | $ 3 | $ (5) | $ 3 | $ 3 |
| Tax benefit (provision) | (1) | 3 | (1) | |
| Unrealized gain (loss) on short-term investments, net of tax | 2 | (2) | 2 | 3 |
| Foreign currency translation adjustment | 159 | (34) | (345) | 19 |
| Tax benefit on translation gain in relation to earnings subject to repatriation | | | | 1 |
| Other comprehensive income (loss) adjustments, net | 161 | (36) | (343) | 23 |
| Net income | 210 | 295 | 712 | 885 |
| Total comprehensive income | $ 371 | $ 259 | $ 369 | $ 908 |

**NOTE (6) STOCK-BASED COMPENSATION PLANS**

The Company grants restricted stock units (RSUs) under the Fourth Restated 2002 Stock Incentive Plan (Fourth Restated 2002 Plan). Each share issued in respect of stock bonuses or stock units is counted as 1.75 shares toward the limit of shares made available under the Fourth Restated 2002 Plan. The Company issues new shares of common stock upon exercise of stock options and vesting of RSUs.

**Table of Contents**

**NOTE (6) STOCK-BASED COMPENSATION PLANS (Continued)**

Under the Fourth Restated 2002 Plan, which was amended in July 2008 by the Board of Directors, prospective grants of RSUs will be subject, upon certain terminations of employment, to quarterly, as opposed to daily vesting. Previously awarded RSU grants continue to involve daily vesting upon certain terminations of employment. Additionally, employees who attain certain years of service with the Company will receive shares under accelerated vesting provisions on the annual vesting date rather than upon qualified retirement. These changes were effective for the grant of RSUs that occurred in the first quarter of 2009.

Compensation expense for all stock-based awards granted subsequent to fiscal 2002 is recognized using the straight-line method. SFAS No. 123R, Share-Based Payment (as amended) (SFAS 123R) requires the estimation of the number of stock-based awards that will ultimately not complete their vesting requirements (forfeitures) and requires that the cumulative compensation expense recognized equals the number of stock-based awards vested at the end of each reporting period. While options and RSUs granted to employees generally vest over five years, with an equal amount vested on each anniversary of the grant date, all grants allow for daily or quarterly vesting of the pro-rata number of stock-based awards that would vest on the next anniversary of the grant date in the event of retirement or voluntary termination. The historical experience rate of actual forfeitures has been minimal. As such, the Company does not reduce stock-based compensation for an estimate of forfeitures because this would result in less compensation expense recognized than the number of stock-based awards expected to vest. The impact of actual forfeitures arising in the event of involuntary termination is recognized as actual forfeitures occur, which generally is infrequent.

*Summary of Stock Option Activity*

The following table summarizes stock option transactions during the first thirty-six weeks of 2009:

| | Shares (in 000 s) | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Term (in years) | Aggregate Intrinsic Value[1] |
|---|---|---|---|---|
| Outstanding at August 31, 2008 | 21,394 | $ 40.04 | | |
| Granted | | | | |
| Exercised | (1,921) | 39.05 | | |
| Forfeited or expired | (102) | 40.34 | | |
| Outstanding at May 10, 2009 [2] | 19,371 | $ 40.13 | 4.25 | $ 128 |
| Exercisable at May 10, 2009 | 17,164 | $ 39.60 | 4.04 | $ 123 |

(1) The difference between the exercise price and market value at May 10, 2009.

(2) Stock options generally vest over five years and have a ten-year term.

The tax benefits realized and intrinsic value related to total stock options exercised during the first thirty-six weeks of 2009 and 2008 are provided in the following table:

**36 Weeks Ended**

| | May 10, 2009 | May 11, 2008 |
|---|---|---|
| Actual tax benefit realized for stock options exercised | $ 7 | $ 73 |
| Intrinsic value of stock options exercised [1] | $ 21 | $ 223 |

(1) The difference between the original exercise price and market value of common stock measured at each individual exercise date.

**Table of Contents**

**NOTE (6) STOCK-BASED COMPENSATION PLANS (Continued)**

*U.S. Attorney s Office Investigation on Certain Stock Options*

As previously disclosed, in 2006, a special committee of independent directors was formed to determine whether the stated grant dates of stock options were supported by the Company s books and records. In March 2007, the Company was informed by the U.S. Attorney s Office in the Western District of Washington that the office was conducting an investigation of the Company s past stock option granting practices to determine whether there had been any violations of federal law. As part of this investigation, the U.S. Attorney s Office served a grand jury subpoena on the Company, seeking documents and information relating to its historic stock option grants. On February 12, 2009, the U.S. Attorney s Office publicly announced that it had closed its investigation.

*Employee Tax Consequences on Certain Stock Options*

The Company is examining alternatives to mitigate the potential adverse tax consequences associated with effected unexercised options held by Canadian employees that were the subject of an accounting adjustment in 2006. The related liability as of May 10, 2009 and August 31, 2008 was $2 and $9, respectively.

*Summary of Restricted Stock Unit Activity*

RSUs granted to employees and to non-employee directors generally vest over five and three years, respectively; however, the Company provides for accelerated vesting for recipients that have attained certain years of service with the Company. Recipients are not entitled to vote or receive dividends on unvested shares. The fair value of RSUs, for financial statement purposes, is the market value of the common stock on the measurement date less the present value of the expected dividends forgone during the vesting period. At May 10, 2009, 5,284,000 RSUs were available to be granted to eligible employees and directors under the Fourth Restated 2002 Plan.

The following awards were outstanding at the end of the third quarter of 2009:

- 7,892,000 shares of time-based RSUs, in which the restrictions lapse upon the achievement of continued employment over a specified period of time;

- 703,000 performance RSUs, of which 305,000 were approved in the first quarter of 2009 and will formally be granted to certain executive officers of the Company upon the achievement of specified performance targets for 2009. Once formally granted, restrictions lapse upon achievement of continued employment over a specified period of time. The Company recognized compensation expense for these awards as it is deemed probable that the performance targets will be achieved.

The following table summarizes RSU transactions during the first thirty-six weeks of 2009:

| | Number of Units (in 000 s) | Weighted-Average Grant Date Fair Value |
|---|---|---|
| Unvested at August 31, 2008 | 6,705 | $ 56.97 |
| Granted | 3,691 | 50.85 |
| Vested | (1,711) | 55.69 |
| Forfeited | (90) | 55.49 |
| Unvested at May 10, 2009 | 8,595 | $ 54.61 |

16

**Table of Contents**

**NOTE (6) STOCK-BASED COMPENSATION PLANS (Continued)**

*Summary of Stock-Based Compensation*

The following table summarizes stock-based compensation expense and the related tax benefits:

| | 12 Weeks Ended | | 36 Weeks Ended | |
|---|---|---|---|---|
| | **May 10, 2009** | **May 11, 2008** | **May 10, 2009** | **May 11, 2008** |
| Restricted stock units | $ 32 | $ 20 | $ 94 | $ 65 |
| Stock options | 11 | 16 | 38 | 51 |
| Total stock-based compensation expense before income taxes | | | | |